CORE REGULATORY FORUM

Q1 UPDATE

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Regulatory Deadlines

- Form 13F – May 16
- Quarterly Form PF – May 30
- Form D – 15 Days after First Sale
- Schedule 13D/G – 10 Days after Triggering Transaction
- New State Privacy Deadlines – January 1 / July 1

Notable News Headlines

- "First Republic Bank Failure: A Timeline…"
  Forbes
- World Economic Outlook: A Rocky Recovery
  IMF
- "UBS Expects $17B hit from Credit Suisse rescue, flags hasty due diligence"
  CNBC

Upcoming Events

- Real Estate Roundtable – **September 2023**
- Energy Roundtable – TBD

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Regulatory Updates and Enforcement

Introduction

After the Federal Reserve initiated a series of interest rate hikes beginning in March 2022 to curb inflation, and following the 2022 collapse of the cryptocurrency platform FTX (as discussed in the CORE Q4 Regulatory Update), the first quarter of 2023 brought a wave of notable bank failures. The US bank crisis started with the collapse of cryptocurrency-focused Silvergate Bank in early March 2023, with the larger crypto-focused Signature Bank failing shortly thereafter. Venture capital friendly Silicon Valley Bank (***SVB***), also a premier provider of private fund subscription-based lending facilities, failed within days of Silvergate Bank. First Republic Bank, initially viewed as an alternative for fleeing SVB customers, ultimately failed as well on May 1, 2023. As in prior bank crises, the US government moved swiftly to backstop uninsured depositors at SVB and Signature Bank, although politicians and others have argued that the current government interventions were different than the maligned bank bailouts that followed the 2007-2008 credit crisis. Meanwhile, US bank stability concerns created shock waves across the Atlantic in Europe and throughout the global markets. Swiss-based investment banking giant, Credit Suisse, also collapsed in March 2023 and was bought by rival UBS with backing from the Swiss government.

The initial run on SVB impacted many private fund managers and left them quickly scrambling to establish new banking relationships with money center banks that had more stringent anti-money laundering (***AML***) and other gating requirements. These activities have further caused many fund managers to reevaluate their banking counterparty diligence and diversification practices. Many private equity, real estate, and other private fund managers are experiencing the effects of increasingly conservative debt lending practices that preceded the crisis and which continues at an aggravated level. As with any crisis, regulators are working to implement new regulations to anticipate, detect and prevent similar future crises. Although changes to Form PF were already underway before the current bank debacle began, Securities and Exchange Commission (***SEC***) Chairman Gensler and Democratic Commissioners were quick to cite the banking crisis as primary evidence of the need for additional reporting by private funds in Form PF when approving recent amendments. Undoubtedly, there will be more ramifications to follow, as regulation and business practices evolve and investors voice their concerns and expectations through operational due diligence demands.

During the first quarter, there were several significant staff changes at the SEC. Eric Werner, a long-time member of the SEC Enforcement Division, became the Regional Director of the Fort Worth Regional Office. Silvestre Fontes rejoined the SEC's Boston Regional Office as Regional Director, after previously serving in the Enforcement Division of that office for 13 years. Most recently Fontes served as Chief Compliance Officer of a Boston-based private fund manager. Deborah Jeffrey was appointed Inspector General (***IG***) for the SEC, having previously served as IG of AmeriCorps and as a private practice lawyer who represented individuals in the Enron case and other notable enforcement actions. Renee Jones, Director of the Division of Corporation Finance, left the agency to return to a faculty position at Boston College Law School. Jones was replaced by Erik Gerding, the Division's Deputy Director. Paul Munter was officially appointed Chief Accountant after serving in this role in an acting capacity since 2021. Mr. Munter previously served as a technical partner at KPMG and a senior instructor of accounting at the University of Colorado.

Recent SEC Rulemaking

One pending rule proposal was finalized in the first quarter of 2023, and the first of two Form PF proposals was adopted after quarter-end but prior to publication date. The adopted Form PF amendment will require large hedge funds to begin reporting material events, including among others extraordinary investment losses, significant margin and counterparty defaults, significant withdrawals or redemptions, and other key events within 72 hours, beginning in November 2023. Private equity funds will similarly be required to report material events, including among others removal of a fund's general partner, early termination of a fund's life, and clawback of incentive compensation. Such reports will be required within 60 days after calendar quarter end. Other additional reporting will be required for large private equity fund filers beginning in 2024. CORE will include a full summary of the Form PF amendment in the Q2 Quarterly Update.

Many other proposed rules remain pending as of the date of this publication. Comment periods for several pending proposals, including the investment adviser cybersecurity risk management proposal and the beneficial ownership proposal, were recently reopened amidst pressure to allow more time for those in the industry to review, analyze and formulate comments. In spite of such pressure, the pace of rulemaking continued with multiple new proposals coming forward during the quarter. While most rulemaking by the SEC is outward focused, the agency issued a proposal in February 2023 that would revise its internal regulations under the Privacy Act to clarify, update, and streamline the process for individuals to request access to and amendment of records pertaining to themselves. Following are SEC rulemaking highlights from the quarter.

T+1 Trade Settlements Final Rule

On February 15, 2023, the SEC adopted changes to Rules 15c6-1(a) and 15c6-1(c) under the Securities Exchange Act of 1934 (***Exchange Act***) to shorten standard settlement for most securities transactions from two business days after trade date (T+2) to one (T+1). For firm commitment offerings priced after 4:30pm ET, the settlement cycle was reduced from four business days after trade date (T+4) to two (T+2). In addition, the SEC adopted a new rule 15c6-2(a) which will require broker-dealers to either: 1) enter into written agreements that require investment managers and other relevant parties to ensure completion of trade allocations, confirmations, and affirmations as soon as technologically practicable but no later than the end of the day on trade date, or 2) establish, maintain and enforce reasonably designed policies and procedures to ensure completion of the allocation, confirmation, affirmation or any combination thereof, for a transaction as soon as technologically practicable and no later than the end of trade date. Registered investment advisers (***RIAs***) that exercise transactions subject to Rule 15c6-2(a), specifically those transactions where a broker-dealer engages in the allocation, conformation, or affirmation process with another party(ies) to achieve settlement of a securities transaction that is subject to the requirements of 15c6-1(a) will be subject to new books and records requirements. Amended Rule 204-2(a)(7)(iii) of the Advisers Act of 1940 (***Advisers Act***) will require such firms to keep records of each confirmation received, and of any allocation and each affirmation sent or received, with a date and time stamp for each indicating when it was sent or received. The amended rules were effective May 5, 2023 and are subject to a May 28, 2024 compliance date. The amended rules primarily impact broker dealers but may necessitate amended broker agreements with RIAs to ensure prompt completion of trade allocations. RIAs will benefit from quicker trade settlements and may be required to establish procedures to ensure prompt trade allocations and update books and records procedures to maintain required time-stamped documentation of allocation instructions and affirmations.

SEC Press Release – https://www.sec.gov/news/press-release/2023-29

Safeguarding Rule Proposal

The SEC proposed amendments on February 15, 2023 to Rule 206(4)-2 under the Advisers Act (the ***Custody Rule***, proposed to be renamed the "***Safeguarding Rule***" aka Safeguarding Client Assets, and re-numbered). The proposal, which is applicable to RIAs but not exempt reporting advisers (***ERAs***), would expand the scope of investment advisory activities deemed to constitute "custody" to include advisers that have discretionary trading authority, with limited exceptions from the definition or from the surprise examination requirement under the rule. Accordingly, a surprise examination would not be required where an adviser's discretionary authority only permits wiring assets upon a corresponding transfer into the account (i.e., DVP settlement instructions). Neither would a surprise exam be required as a result of a standing letter of authorization (***SLOA***) specifying limited adviser authority so long as such letter includes specific provisions. In addition, the proposal would expand the scope of the rule to cover all assets, including digital assets or cryptocurrency as well as other assets over which an adviser has custody but may not be deemed "securities." As in the current Custody Rule, all assets would be required to be held at a qualified custodian with limited exceptions. The proposed rule would include a new exception from holding "physical assets" at a qualified custodian. The current exception for "privately offered securities" would remain but would be narrowed, and reliance on such exception would require an adviser to determine, and document in writing, that ownership cannot be recorded and maintained (book-entry, digital, or

otherwise) in a manner in which a qualified custodian can maintain possession or control of such assets. The proposal specifically notes that the SEC does not believe crypto asset securities issued on public, permissionless blockchains would satisfy the conditions of privately offered securities under the proposed Safeguarding Rule, and therefore would need to be held at a qualified custodian. To rely on the exceptions, the adviser would be required to reasonably safeguard any privately offered securities or physical assets that are not maintained with a qualified custodian from loss, theft, misuse, misappropriation, or the adviser's financial impairments. Moreover, the proposed rule would require each privately offered security or physical asset not maintained with a qualified custodian to be verified by an independent public accountant, including any purchase, sale or transfer of such asset. The accountant would be required to notify the SEC upon finding any material discrepancies with respect to such verification.

The audit provision currently available under the Custody Rule to pooled investment vehicles would be extended to any advisory client whose financial statements are able to be audited in accordance with the rule. In addition, the audit provision would require financial statements of non-U.S. clients to contain information substantially similar to statements prepared in accordance with U.S. GAAP and material difference with U.S. GAAP to be reconciled. The amended rule would also include a requirement that there be a written agreement between the adviser or entity and the auditor requiring the auditor to notify the SEC of the auditor's termination or issuance of a modified opinion. Audited financial statements would continue to be required to be delivered within 120 days of FYE for investors of audited entities, 180 days of FYE for funds of funds, and 260 days for funds of funds of funds. Consistent with a current position in the SEC's Custody Rule FAQ, the proposal includes a statement that failure to meet an audit deadline due to reasonably unforeseeable circumstances would not provide a basis for enforcement action as long as the adviser believed the audited financial statements would be distributed by the applicable deadline.

The proposed rule would also:

- Include additional requirements for segregation of client assets, limitations on commingling assets with the adviser or its related persons, and prohibitions with respect to client assets being subject to any rights, charges, liens or other claims in favor of the adviser or related persons except where the client agrees in writing;
- Require that an adviser enter into a written agreement with and obtain certain reasonable assurances from qualified custodians to ensure clients receive certain standard custodial protections when an adviser has custody of their assets. These protections are designed, among other things, to ensure client assets are properly segregated and held in accounts designed to protect the assets in the event of a qualified custodian bankruptcy or other insolvency;
- Retain the current Custody Rule's requirement for an adviser to undergo a surprise examination by an independent public accountant to verify client assets, but expand the availability of the current custody rule's audit provision as a means of satisfying the surprise examination requirement;
- Amend the investment adviser recordkeeping rule to require advisers to keep additional, more detailed records regarding client accounts and discretionary authority, trade and transaction activity, and position information for each client account of which it has custody; and
- Amend Form ADV to align advisers' reporting obligations with the proposed Safeguarding Rule's requirements and to improve the accuracy of custody-related data available to the SEC, its staff, and the public.

Private fund managers are already presumed to have custody under the current Custody Rule. Most of our clients currently rely on the audit provision under the rule. However, many private equity and other real asset managers routinely rely on the privately offered securities exception and would therefore be directly impacted by the revisions to that exception. Firms that manage digital assets and all advisers deemed to have custody would need to review custodial arrangements, agreements and related records to comply with the amended rule.

SEC Press Release – https://www.sec.gov/news/press-release/2023-30

Regulatory Updates and Enforcement

Regulation S-P Amendments Proposal

On March 15, 2023, the SEC proposed amendments to Regulation S-P (***Reg S-P***) which was initially adopted in 2000. Reg S-P currently requires broker-dealers (***BDs***), investment companies (***ICs***), and RIAs to 1) adopt written policies and procedures to safeguard customer records and information (the ***safeguards rule***); 2) ensure disposal of consumer report information in a manner that protects against unauthorized access to or use of such information (the ***disposal rule***); and 3) deliver privacy notices and opt out provisions to its *individual* customers (but not institutional customers) initially and annually. The proposed amendments to Reg S-P would extend the rules to cover transfer agents (***TAs***, and together with BDs, ICs, and RIAs referred to as ***covered institutions***).

The amendments would also expand the information covered under the rule and require additional documentation of compliance with the requirements of the safeguards rule and disposal rule. The proposed amendments would define "***customer information,***" as applicable to all elements of Reg S-P, to encompass any records containing "nonpublic personal information" (as defined in Regulation S-P) about "a customer of a financial institution," whether in paper, electronic or other form that is handled or maintained by the covered institution or on its behalf. Further, the amended rule would apply to both nonpublic personal information that a covered institution collects about its own customers and to nonpublic personal information it receives from a third-party financial institution about that institution's customers.

The amendments would require covered institutions to adopt or expand written policies and procedures to include the following provisions:

- Incident Response Program – Must establish a formal incident response program reasonably designed to detect, respond to, and recover from unauthorized access to or use of customer information. The program must include procedures to assess the nature and scope of any such incident and contain and control the indent. The Incident Response Plan must address the risk of harm posed by compromises at service providers and mandate contractual provisions requiring the service provider to protect against unauthorized access to or use of customer information and notify the covered institution within 48 hours after becoming aware of any breach that results in unauthorized access to customer information maintained by the service provider.
- Customer Notification Requirement – Covered institutions would be required to notify affected individuals whose sensitive customer information was or is reasonably likely to have been accessed or used without authorization as soon as reasonably practicable but no later than 30 days after becoming aware that such unauthorized access occurred. Notification would not be required if the covered institution determines that the sensitive customer information was not actually, and is not reasonably likely to be, used in a manner that would result in substantial harm or inconvenience.

The proposed amendments would confirm that an RIA, BD or IC is not required to deliver an annual privacy notice if it only shares nonpublic personal information with third parties as necessary to effect, administer or conduct authorized activities consistent with provisions in the Gramm-Leach-Bliley Act (***GLBA***) and has not changed its policies and practices with respect to disclosing nonpublic personal information from what was described in the most recent privacy notice.

The proposed provisions under the Reg S-P are largely included as best practices in many private fund managers' existing privacy and information security policies and procedures. However, if the proposal is adopted such firms will need to ensure that they have established policies and procedures that comply with each of the above elements and are prepared to promptly identify, contain and resolve security incidents and make prompt notifications. In addition, firms will need to evaluate service provider due diligence, relationships and agreements to ensure compliance with the amended rules.

SEC Press Release – https://www.sec.gov/news/press-release/2023-51

Regulatory Updates and Enforcement

Market Entities Cybersecurity Proposal

In March 2023, the SEC proposed an additional rule that would require broker-dealers, national securities exchanges, clearing agencies, national securities associations, major security-based swap participants, security-based swap data repositories, security-based swap dealers, transfer agents, and the Municipal Securities Rulemaking Board (collectively, Market Entities) to establish, maintain, and enforce written policies and procedures that are reasonably designed to address their cybersecurity risks. Like the proposal for investment advisers, Market Entities would be required to conduct periodic cybersecurity risk assessments, conduct annual reviews of their cybersecurity policies and procedures, utilize monitoring and testing to detect, mitigate and remediate cybersecurity threats and vulnerabilities, and immediately notify the SEC in the event of a significant cybersecurity incident.

SEC Press Release – https://www.sec.gov/news/press-release/2023-52

Regulation SCI Proposal

Regulation Systems Compliance and Integrity (***SCI***) was adopted in 2014 to help ensure the capacity, integrity, resiliency, availability, and security of the technology infrastructure of the U.S. securities markets. The initial rule applied to national securities exchanges, registered clearing agencies, registered securities associations, other self-regulatory organizations, certain alternative trading systems, certain exempt clearing agencies, and certain market data disseminators. The rule requires such market participants to maintain reasonably designed policies and procedures, review and test to ensure their systems are designed to maintain operational capability and promote fair and orderly markets. The rule further requires such entities to take appropriate corrective actions and make reports and disclosures in the event of an "SCI event" as defined in the rule, which includes a systems disruption, systems intrusion, or systems compliance issue. A March 2023 proposed amendment would extend the requirements of Regulation SCI to additional market participants, including certain large broker-dealers, registered security-based swap data repositories, and all clearing agencies exempt from registration. The amendment would also strengthen the requirements imposed on all covered market participants, including a required inventory and classification of systems, program for life cycle management, program to prevent unauthorized access, and additional provisions with respect to cloud and other third-party service providers. The rule would expand SEC reporting requirements and recordkeeping provisions. Amended Reg SCI would not be directly applicable to private fund managers but would impact market entities with which they conduct business. The Regulation SCI proposal is part of the SEC's broader cybersecurity and resiliency initiatives.

SEC Press Release – https://www.sec.gov/news/press-release/2023-53

Asset Backed Securities Conflicts of Interest Proposal

In January 2023, the SEC re-proposed a new Rule 192 under Section 27B of the Securities Act of 1933 (***Securities Act***), more than 10 years after it was originally proposed following the adoption of the Dodd-Frank Act. The new rule would prohibit certain market participants and their affiliates, including underwriters, placement agents, initial purchasers, and sponsors of any asset-backed security (***ABS***) or synthetic ABS (***securitization participants***), from engaging, directly or indirectly, in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in an ABS during the applicable prohibition period, subject to certain exceptions. The proposed rule targets transactions that effectively represent direct or indirect bets against the relevant ABS, or transactions that could incentivize a securitization participant to structure an ABS such that the securitization participant's interests would be placed ahead of those of the ABS investors. Such transactions were the subject of regulatory and Congressional investigations and were among the most widely cited examples of ABS-related misconduct during the lead up to the financial crisis of 2007-2009. Prohibited transactions would specifically include:

- a short sale of the relevant ABS;

- the purchase of a credit default swap (***CDS***) or other derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of a specified adverse event with respect to the ABS; or
- the purchase or sale of any financial instrument (other than the ABS) or entry into a transaction through which the securitization participant would benefit from the actual, anticipated, or potential occurrence of any of the following with respect to the ABS:
  - adverse performance of the asset pool;
  - loss of principal, monetary default, or early amortization event; or
  - decline in the market value

The rule would include exemptions for risk-mitigating hedging activities, commitments to provide liquidity, and bona fide market making activities. The proposed rule would potentially impact private fund managers who sponsor or manage collateralized loan obligations (***CLOs***) or otherwise engage in ABS transactions.

SEC Press Release – https://www.sec.gov/news/press-release/2023-17

Exam Developments

The Division of Examinations (***Exam Division***) issued its 2023 Examination Priorities on February 7, 2023, including many that directly impact private fund managers and other investment managers. The Exam Division examined approximately 15% of the more than 15,000 registered investment adviser population in fiscal year 2022. CORE has clearly seen an uptick in examination activity recently among our clients. The Exam Division has undertaken and expects to undertake in 2023 a variety of examinations as well as other efforts to support its mission of: 1) promoting compliance; 2) preventing fraud; 3) monitoring risk; and 4) informing policy.

FY 2023 Examination Priorities

Following are priorities that may impact CORE private fund managers and other advisory clients. Additional priorities will impact registered funds, broker-dealers and other market participants.

- Compliance with New Rules
  - Investment Advisers Act Marketing Rule (206(4)-1)
- Private Fund General Focus Areas
  - Conflicts of Interest
  - Alternative Data & Insider Trading Policy
  - Fees and Expenses – Including private equity fund post-commitment period management fees and the impact of valuation practices
  - Marketing Rule Compliance – Including testimonials, endorsements, and solicitations
  - Custody Rule Compliance – including qualified auditors and timely delivery of audited financials
- Private Fund Specific Risk Focus
  - Highly levered funds
  - SPAC sponsorship or investments
  - Use of affiliated service providers
  - Use of advisory personnel to service funds and portfolio companies
  - Hard to value investments – Including real estate investments and crypto assets
  - Adviser-led restructurings – Including stapled secondaries and continuation funds
- Conflicts of Interest
  - Identification of conflicts
  - Adequacy of policies and procedures to mitigate conflicts

  - Economic incentives such as revenue sharing and commissions
  - Customization of policies and procedures to address business model, compensation structure, products, and customers

- Environmental, Social & Governance (ESG) Investing
  - ESG-related advisory services/fund offering
  - Operations relative to disclosures
  - Fund names and labels

- Information Security & Operational Resiliency
  - Cybersecurity policies, procedures, and governance practices
  - Safeguards for customer records and personal information
  - Cybersecurity issues related to third-party vendors
  - Compliance with Regulations S-P and S-ID
  - Operational resiliency planning

- Crypto Assets & Emerging Financial Technology
  - Disruptions caused by distress in crypto asset markets
  - Compliance, disclosure, and risk management practices
  - Standard of care in recommending or providing advice on crypto assets
  - Digital engagement practices or tools with game-like features

- Other Investment Adviser Issues
  - Compliance programs of newly registered/never examined firms
  - Fee calculations, alternative revenue sources, and excessive fees
  - Electronic communication monitoring and archiving
  - Selection of third-party service providers

- Fiduciary Duty to Retail Investors
  - Delivery of Form CRS
  - Advice, recommendations, and conflicts related to products, investment strategies, and account types
  - Consideration of investor's investment profile, investment goals and account characteristics
  - Advice or recommendations related to higher-risk products/services:
    - Proprietary products
    - Microcap securities
    - Complex products, derivatives and leveraged ETFs/ETNs/ETPs
    - High-cost illiquid products, such as variable annuities and non-traded REITs
    - Unconventional strategies to address rising interest rates
    - Retirement accounts and 529 plans

SEC Exam Priorities Memo – https://www.sec.gov/files/2023-exam-priorities.pdf

Risk Alert: Observations from Examinations of Newly-Registered Advisers

The Exam Division issued a Risk Alert in March 2023 highlighting the typical focus areas reviewed during examinations of newly registered advisers and observations from such exams regarding compliance policies and procedures, disclosures, and marketing practices. Examiners often focus on whether new registrations have: 1) identified and addressed conflicts of interest; 2) provided clients with full and fair disclosure that enables informed consent; and 3) adopted effective compliance programs. Consistent with this focus, document requests and interviews typically address the following, and examiners seek to assess the firm's compliance culture and tone at the top:

- Business and Investment Activities – including information regarding assets under management, the adviser's clients, and the basis for SEC registration; advisory agreements, account statements,

demographic and other data regarding advisory clients and accounts; investment strategies and trading practices; third-party service providers; adviser financial statements and records; details regarding investment and other personnel; and litigation or arbitration involving the adviser or its supervised persons.

- Organizational Affiliations – including organization charts, ownership and control of the adviser and its affiliates.
- Compliance Policies and Procedures – including the firm's compliance manual and code of ethics; information about the adviser's compliance program; risk management practices and framework; internal controls; and information to facilitate testing for regulatory compliance with respect to portfolio management and trading activities.
- Disclosures to Clients – including advertisements and marketing materials, websites, social media, blogs, and other disclosure documents.

Examiners have observed deficiencies related to each of these focus areas as follows:

- Compliance Program Deficiencies – Inadequate resources devoted to compliance; use of off-the-shelf compliance policies that were not adequately tailored to the firm's business; failure to address applicable risk areas such as fees and portfolio management; lack of procedures to enforce stated policies such as best execution; personnel who were not aware of or did not follow policies and procedures; undisclosed conflicts from advisory personnel with multiple duties; inadequate oversight of outsourced business and compliance functions; and inadequate business continuity and succession plans.
- Disclosure Document & Filing Deficiencies – Disclosure documents or regulatory filings that contained omissions or inaccurate information regarding: 1) fees and compensation; 2) business operations; 3) investment strategies, trading or account reviews; 4) disciplinary information; 5) websites and social media accounts; and 6) conflicts of interest.
- Marketing – Marketing materials that contain: 1) false or misleading information regarding advisory personnel's experience or credentials, third-party rankings and performance, or 2) instances where the adviser was unable to substantiate certain factual claims.

SEC Risk Alert – https://www.sec.gov/files/risk-alert-newly-registered-ias-032723.pdf

Risk Alert: Observations from Broker-Dealer Examinations Related to Best Interest

In January 2023, the Exam Division issued a Risk Alert related to examinations of broker-dealers and their compliance with Regulation Best Interest. This regulation and exam staff findings is applicable to broker-dealers rather than investment advisers. However, findings and themes from these exams are similar to highlights from adviser exams and focused on firms': 1) compliance obligations and the adequacy of policies, procedures and training; 2) conflicts of interest obligations and firms' procedures for effectively identifying and mitigating conflicts; and 3) disclosure obligations and the adequacy of disclosures regarding the capacity in which registered representatives act and related conflicts with respect to such activities, as well as the availability or required disclosures on the firm's website.

SEC Risk Alert – https://www.sec.gov/file/exams-reg-bi-alert-13023.pdf

Enforcement Developments

In April 2023, the U.S. Supreme Court issued an opinion that addressed ongoing concerns about the SEC and the Federal Trade Commission exercising excessive authority through administrative proceedings and thereby constricting the rights of individuals and their livelihoods. The justices agreed that people and businesses subjected to administrative proceedings at these agencies can file directly in U.S. District Court seeking to enjoin

or block those proceedings and raise constitutional arguments. In the past, the decisions first had to be appealed internally to the agency before being filed in federal court. The recent opinion reflects a setback to the SEC's ability to pursue litigated matters in its administrative forum. Respondents to administrative proceedings will have the ability to effectively stay the proceedings while vindicating their constitutional rights in federal court.

The industry has seen a significant decline in litigated administrative proceedings over the last several years as respondents raise similar constitutional issues, and the Court's opinion presents another obstacle to those proceedings going forward. The Supreme Court is currently considering a petition from the SEC to hear and opine on the constitutionality of the use of administrative law judges (***ALJs***), following a 2022 split decision in which a Fifth Circuit panel vacated an SEC judgement against hedge fund manager George Jarkesy, finding that the use of the ALJ violated the manager's Seventh Amendment right to a jury trial.

Notwithstanding these ongoing setbacks to the SEC's administrative process, SEC enforcement actions have continued with significant actions against private fund managers and other industry participants and the individuals at those firms. Following are summaries of recent cases involving or instructive for private fund managers.

Compliance Program Failures

E. Magnus Oppenheim & Co. Inc. (March 13, 2023)

The SEC brought a settled action against Manhattan-based E. Magnus Oppenheim & Co. Inc. (***EMO***) for failing to adopt and implement compliance policies and procedures to conduct best execution reviews for its advisory clients concerning its clearing broker, among other deficiencies. The SEC found that EMO's written compliance policies and procedures were adopted from another investment adviser's compliance manual without removing references to the other adviser and without tailoring the manual to its own business. Missing from the borrowed manual were policies and procedures involving access to client funds and custody, billing fees, and conducting due diligence of third-party service providers, all of which were relevant and necessary to EMOs business. The SEC investigation alleged that during a three-year period EMO failed to satisfy its duty to seek best execution because it did not make an adequate assessment of the commission rates, fees, or ticket charges assessed by its clearing broker, try to negotiate better terms with its clearing broker, or make assessment of the commissions, fees, ticket charges, and execution quality available from other clearing brokers. EMO was already on notice for the same issues identified in a SEC exam of the firm in 2019. Although the firm's President/CIO/CCO passed away in 2019, the firm did not follow-up on the compliance deficiencies thereafter.

EMO was thus found to have violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. The firm consented to a censure, a cease-and-desist order, a $50,000 penalty, and the imposition of an independent compliance consultant to assist the firm with such matters in the future.

SEC Litigation Release – https://www.sec.gov/enforce/34-97114-s

Insider Trading

Healthcare Executive Insider Trading Through 10b5-1 Plan (March 1, 2023)

The SEC charged Terren S. Peizer, Executive Chairman of California-based healthcare treatment company, Ontrak Inc., with insider trading for selling more than $20 million of Ontrak stock while in possession of material non-public information (***MNPI***). Peizer became aware of the tenuous nature of the relationship between Ontrak and the company's largest customer which generated over half of its revenue. Peizer established a Rule 10b5-1 trading plan in the name of Acuitas Group Holdings, LLC which he then used as his investment vehicle to sell off Ontrak stock. Peizer attested that he was unaware of any negative MNPI concerning the company's largest customer when he executed the 10b5-1 trading plan. He sold nearly 600,000 shares of Ontrak worth more than $19.2 million using this vehicle. Peizer later initiated a second Rule 10b5-1 trading plan and used it to sell an additional 45,000 stock shares worth an additional 1.9 million. When the company's largest customer terminated the Ontrak contract, stock prices fell more than 44 percent. By implementing his pre-selling scheme via the Rule

10b5-1 plans, Peizer avoided more than $12.7 million in losses that other investors sustained. The SEC complaint alleged that Peizer and Acuitas adopted the Rule 10b5-1 plans while he was aware of MNPI in an effort to evade insider trading prohibitions. The SEC investigation determined that Peizer was not eligible to take advantage of any affirmative defense available to corporate insiders under the 10b5-1 Rule.

Amendments to Rule 10b5-1 have recently become effective for situations such as this. According to the SEC, the reforms will further prevent unlawful trading by executives on the basis of non-public information and help build greater confidence in the market. Peizer's attempt to avoid million in losses that traditional investors absorbed was deemed abuse of his position for personal advantage. In a parallel action, the US Department of Justice filed criminal charges against Peizer and Acuitas for violating antifraud provisions of the federal securities laws. Permanent injunctive relief, disgorgement of ill-gotten gains with prejudgment interest, civil penalties, and an officer and direct bar of Peizer are being sought.

SEC Press Release – https://www.sec.gov/news/press-release/2023-42

Insider Trading Ahead of Government Partnership in COVID-19 Response (February 23, 2023)

In February 2023, the SEC charged Andrew Stiles and Stiles' cousin, Gray Stiles, with insider trading in Eastman Kodak Company (Kodak) and Novavox stocks based on nonpublic information related to the companies' planned government partnerships to assist in the fight against COVID-19 at the height of the pandemic. The illegal trading activities netted the two defendants more than $1.5 million in profits. Andrew Stiles worked at a medicine supply chain company that was assisting Kodak in obtaining funding from the federal government to produce key materials and ingredients to produce medicines with a focus on responding to the COVID-19 pandemic. Based on MNPI regarding the potential government funding, Mr. Stiles purchased Kodak stock in breach of a duty of confidentiality and tipped his cousin who also purchased shares. After public announcements regarding the funding, each sold their shares for extensive collective profits. Andrew Stiles also previously worked with a public accounting firm that provided consulting services with Novavax, a pharmaceutical company, and in that capacity assisted Novavax's efforts to obtain government funding for its efforts to develop a COVID-19 vaccine. The SEC further alleged that Andrew Stiles purchased shares of Novavax stock based on MNPI about the company's efforts to secure such funding. This additional trading garnered Andrew Stiles more than $45,000 in illicit profits. Andrew Stiles repeatedly abused his position as a government contract consultant to generate illegal trading profits. The U.S. Attorney's Office announced criminal charges against Andrew Stiles and Gray Stiles. Both men are charged with violating the antifraud provisions of the securities laws. The SEC is seeking permanent injunction, disgorgement, civil penalties, and an officer and director bar against Andrew Stiles.

SEC Press Release – https://www.sec.gov/news/press-release/2023-38

Special Purpose Acquisition Companies (SPACs)

Hedge Fund SPAC Insider Trading Scheme (March 30, 2023)

As we have highlighted in multiple recent regulatory updates, the SEC is heavily focused on SPACs including proposed rulemaking and examination initiatives. In a recent enforcement action, Sean Wygovsky, a former trader at a Canadian asset management firm, and Cristopher Matthaei, a former partner at a U.S. broker-dealer, were charged by the SEC for alleged use of nonpublic information in advance of at least seven merger announcements involving SPACs to earn unlawful profits of more than $3.4 million. The complaint alleges that Wygovsky obtained MNPI about SPAC mergers from his employer's involvement in transactions related to the mergers. Wygovsky used encrypted messages to tip his friend and trading client Matthaei about the upcoming mergers. Matthaei, who ran a trading and research group focused on SPACs, traded on the tips.

According to SEC enforcement investigators, both industry professionals abused their positions to trade inside information and profit from it. They are charged with violating the antifraud provision of the federal securities laws. For both perpetrators permanent injunctive relief, disgorgement of fraudulent gains, prejudgment interest, and civil penalties are sought. Additionally, an officer and director bar against Matthaei is sought. Wygovsky consented to a bifurcated settlement, subject to court approval under which he will be permanently enjoined from

violating federal securities laws. Wygovsky was previously charged with perpetrating a front running scheme and consented to a bifurcated settlement in that matter as well. The U.S. Attorney's Office is pursuing criminal charges against Matthaei in the ongoing matter.

SEC Press Release – https://www.sec.gov/news/press-release/2023-66

African Gold Acquisition SPAC Fraud & Regulatory Failures (February 22, 2023 and January 3, 2023)

SEC charges have recently been settled against African Gold Acquisition Corp., a publicly traded SPAC, for internal controls, reporting, and recordkeeping violations. The failures enabled African Gold's former Chief Financial Officer (CFO) , Cooper J. Morgenthau, to misappropriate $1.2 million from the company's operating bank account. As a result of the misconduct, African Gold made false filings with the SEC and maintained inaccurate books and records. African Gold gave the CFO control over its operating bank account and financial reporting process with little to no oversight. This failure on the part of the corporation enabled Morgenthau to make unauthorized withdrawals from the company's operating bank account and direct that money to himself without detection for more than one year. Morgenthau was able to alter the company's bank account statements to conceal the fraud. As a result, African Gold misstated information in required financial filings with the SEC and failed to maintain accurate books and records on behalf of the corporation. African Gold agreed to a cease-and-desist order and to pay a $103,591 civil monetary penalty for its supervisory failures.

Additionally, the SEC charged Morgenthau individually with orchestrating the embezzlement scheme in which he stole more than $5 million from the company and its investors in SPAC's that he incorporated. He stole from a SPAC series called Strategic Metals Acquisition Corp. I and II to pay for personal expenses, to trade in crypto assets and other securities, and to conceal his embezzlement from African Gold funds. Morgenthau was personally charged with violating federal securities laws for misappropriating money from the company's bank account, lying to African Gold's accountants and auditors, circumventing and failing to implement internal accounting controls, falsifying books and records, and filing false certifications with the SEC. Morgenthau consented to a judgment enjoining him from further federal securities laws violations and barring him from serving as an officer or director of a publicly traded company. Monetary remedies are still being determined. The U.S. Attorney's Office is simultaneously pursuing criminal charges against Morgenthau.

SEC Press Releases – https://www.sec.gov/news/press-release/2023-36 and https://www.sec.gov/news/press-release/2023-1

Valuation

Bloomberg Misleading Disclosures in Fixed Income Valuation Service (January 23, 2023)

On January 23, 2023, the SEC filed a settled action against Bloomberg Finance L.P. for misleading disclosures relating to BVAL, its paid subscription service that provides price valuations for fixed-income securities to financial services entities. According to the SEC order, BVAL provides prices for mutual funds, hedge funds and money manager, on a daily basis for over 2.5 million securities across all asset classes, including thinly-traded and hard-to-price fixed income securities. Bloomberg disclosed to customers that its independent valuations of fixed income securities are derived by using proprietary algorithmic methodologies. However, from 2016-2022 Bloomberg failed to disclose to its BVAL customers that the valuations it provided for certain fixed-income securities could be based on a single data input, which did not adhere to the methodologies it disclosed. The SEC determined that Bloomberg assumed a critical role as a pricing service to participants in the fixed-income markets, and therefore it was incumbent upon Bloomberg to provide accurate information to customers about their valuation processes. The SEC found Bloomberg responsible for failing to uphold its duty thereby violating section 17(a)(2) of the Securities Act. Bloomberg agreed to cease and desist from future violations and pay a $5 million penalty. The SEC noted that Bloomberg voluntarily engaged in remedial efforts to make improvements to its BVAL line of business.

SEC Press Release – https://www.sec.gov/news/press-release/2023-14

Regulatory Updates and Enforcement

Market Manipulation

Multi-Million Dollar Scheme to Spread & Trade on False Rumors (February 16, 2023)

On February 16, 2023, the SEC brought charges against the final participant in a multi-million-dollar scheme to spread and trade on false rumors. Milan Vinod Patel was charged for spreading more than 100 false rumors about public companies to generate more than $1 million in illicit trading profits. The SEC previously charged Barton Ross, Mark Melnick, Anthony Salandra, and Charles Parrino for their roles in the same scheme. Patel disseminated rumors he knew to be false through his contacts at financial news services, chat rooms, and message boards sharing dishonest information about purported market-moving events such as corporate mergers or acquisitions involving publicly-traded companies. Patel specifically disseminated rumors to Melnick, a host of a stock trading webcast, and used Melnick's list of webcast subscribers to impact stock prices. The fabricated rumors caused prices of subject companies to rise temporarily, which allowed Patel to sell his holdings in the securities and generate more than $1 million in illicit trading profits. Patel played the central role of involving others in the scheme and using his contacts to spread the rumors. While litigation is pending, Patel was charged with violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

SEC Press Release – https://www.sec.gov/news/press-release/2023-33

Pre-IPO Activities

StraightPath Venture Partners Fraud and Unregistered Broker-Dealer Activity (March 23, 2023)

The SEC charged Scott Hollender, Gabriel Migliano, Jr. and Frank Vecchio for selling interests in shares of pre-IPO companies on behalf of StraightPath Venture Partners LLC, despite none of these individuals being registered broker-dealers. The three defendants are further charged with misleading investors about the fees associated with the investments.

The SEC previously charged StraightPath Venture Partners, StraightPath Management LLC, and its four principals in connection with this $410 million fraud. The respondents charged in the complaint solicited investments for interests in funds that were set up as series LLCs which claimed to acquire shares of a single pre-IPO company. Hollender, Migliano, and Vecchio provided investors with marketing materials, advised investors on the merits of the investments, and received transaction-based compensation in spite of the fact that none of the men were registered brokers. They collectively solicited over $13 million in investments from at least 115 investors and received upfront commissions of approximately 10 percent on investments solicited. The defendants falsely told investors that there were no upfront fees associated with their investments while collectively receiving $3.7 million in transaction-based compensation.

The SEC's complaint charged the defendants with violating antifraud and other provisions of the federal securities laws. It sought permanent injunctive relief, return of ill-gotten gains and civil penalties. The complaint also named GSH Empire Inc. and 21st Century Gold & Silver Inc., entities controlled by Hollender and Vecchio, as relief defendants for the purpose of recovering unlawful gains generated through their conduct. The investigation is ongoing.

SEC Press Release – https://www.sec.gov/news/press-release/2023-61

Unregistered Broker-Dealer Activity Relating to Pre-IPO Funds (March 3, 2023)

The SEC charged Silver Edge Financial LLC, its owner Daniel J. Mackle, Sr., Equity Acquisition Company (***EAC***)., its owner Carsten Klein, and six sales staff with unregistered broker-dealer activity relating to their sales of interests in shares of pre-IPO companies. The defendants sold interests in funds that were set up as series LLCs, with each series representing an interest in shares of a single pre-IPO company. The underlying assets in these series were interests in shares of companies that were expected to undertake an initial public offering or other liquidity within two-to-five years. Those involved in the unlawful activity raised more than $65 million while failing to register as brokers with the SEC. Carsten Klein, owner of EAC, acted as an unregistered dealer in connection with their business of obtaining pre-IPO shares and offering them for sale to pre-IPO funds. EAC purchased more

than 14 million shares of pre-IPO companies and sold more than $13.4 million in shares to pre-IPO funding, while keeping the remaining shares in inventory.

The SEC order noted that individuals and entities in the pre-IPO space must comply with the SEC's registration provisions when selling securities backed by pre-IPO shares and cannot avoid responsibilities, regulatory obligations, inspections and maintaining appropriate books and records. All respondents agreed to cease and desist from future violations. Silver Edge and Mackle agreed to pay disgorgement and prejudgment interest of more than $2.5 million and a civil penalty of $975,000. They agreed to industry and penny stock bars with the right to reapply after five years. EAC and Klein agreed to pay disgorgement and prejudgment interest of more than $3.6 million and a civil penalty of $269,360. Silver Edge, Mackle, EAC and Klein also agreed to undertakings that will ensure the legal and orderly distribution of pre-IPO interests. The six salespeople – Scott Esposito, Richard Konopka, Robert Daniel Louise, Dave Nicolas, Joshua Simmons, and Daniel Esposito – agreed to pay civil penalties ranging from $61,000 to $124,320 and to industry and penny stock bars.

SEC Press Release – https://www.sec.gov/news/press-release/2023-44

Regulation M Rule 105 Violations

HITE Hedge Asset Management (February 21, 2023)

On February 21, 2023 HITE Hedge Asset Management LLC settled a complaint brought by the SEC for violating SEC Rule 105 of Regulation M by purchasing stock in a public offering for five private fund clients after selling short the same stock, during the 5-day prohibited period under the SEC Rule. Three private funds, HITE Hedge LP, HITE Hedge II LP and HITE Hedge Offshore Ltd. were also named as relief defendants in the matter as they ultimately received the profits from the unlawful trading. Rule 105 prohibits short selling an equity security during a restricted period immediately prior to the offering and then purchasing the same security in the covered offering, absent an exception. The Rule is intended to prevent potentially manipulative short selling before the pricing of covered offerings.

At the time of the prohibited occurrence, HITE Hedge Asset Management did not have formal written policies relating to Rule 105. The SEC complaint alleges that it was not until after the SEC began its investigation into the illegal trading that the firm implemented a written Rule 105 policy and enhanced other compliance measures. The firm consented to a final judgment ordering it to pay a penalty of $103,591, disgorge profits of $18,236 and pay interest of $806. HITE Hedge II LP agreed to a final judgment to disgorge profits of $39,975 and pay interest of $1,768. HIT Hedge Offshore Ltd. agreed to disgorge profits of $53,417 and pay interest of $2,362. HITE Hedge Asset Management further agreed to an entry stating that it violated SEC Rule 105 and agreed to a cease and desist from committing or causing further violations of Rule 105.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/2023/lr25643.htm

Candlestick Capital Management (February 21, 2023)

On the same day, the SEC settled a complaint against investment advisory firm Candlestick Capital Management LP for violating SEC Rule 105 when it purchased stock in a public offering for two private fund clients after selling short the same stock for those clients, during the previous 5-day period prohibited by the rule. Two private fund clients, Candlestick Capital Master Fund LP and Candlestick US F&F Fund LP, were named as relief defendants in the matter. Candlestick Capital agreed to pay an $810,000 penalty to settle the charges. The two private fund clients agreed to disgorge profits totaling approximately $1.6 million, plus prejudgment interest, from the unlawful trading. The settlement is subject to court approval.

Although Candlestick Capital concluded that it had violated Rule 105, the firm did not initiate a formal review of its trading history or self-report the discovered violation to the SEC. The firm only acknowledged the violation after SEC staff made inquiries about it in a routine examination. Candlestick Capital has since undertaken remedial steps, including revising its Rule 105 policies and procedures.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/2023/lr25642.htm

Regulatory Updates and Enforcement

Conflicts of Interest

Moors & Cabot Failure to Disclose Compensation and Conflicts of Interest (January 19, 2023)

The SEC brought charges against RIA, Moors & Cabot, Inc., for breach of fiduciary duties to advisory clients in connection with disclosure failures related to revenue sharing and incentive payments received from clearing brokers. The firm was also charged with failing to implement disclosure-related policies and procedures. The SEC alleged that Moors & Cabot failed to provide full and fair disclosures regarding material facts and conflicts associated with its receipt of compensation from its clearing brokers. The unlawful compensation included: (1) transaction fee discounts and incentive credits that were contingent upon meeting dollar amount thresholds in cash sweep programs offered by the clearing brokers; (2) revenue sharing payments based on the amount of advisory clients' assets in cash sweep programs; (3) revenue sharing payments from margin loans provided to the firm's advisory clients; and (4) revenue sharing payments from postage and handling fees that one clearing broker charged to the firm's advisory clients. According to the SEC complaint, the revenue sharing payments and financial incentives presented conflicts of interest because they created incentives for the firm to allocate clients' asset to cash, recommend cash sweep options, recommend margin loans, and utilize the clearing brokers. Per the SEC findings, Moors & Cabot did not adequately disclose the compensation arrangement or the conflicts of interest to clients. The firm also failed to fully and fairly disclose its disciplinary history and the history of two investment adviser representatives with previous questionable conduct. Additionally, the firm failed to implement compliance policies and procedures related to disclosure, conflicts of interest and disciplinary histories. Moors & Cabot was charged with violating Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and agreed to pay disgorgement of $1,436,182, prejudgment interest of $88,274, and a civil penalty of $375,000 and to distribute funds to harmed investors.

SEC Administrative Release – https://www.sec.gov/enforce/34-96719-s

Former BlackRock Portfolio Manager Undisclosed Conflicts (January 5, 2023)

Randy Robertson, a former BlackRock Advisors, LLC portfolio manager, was charged by the SEC for failing to disclose a conflict of interest arising from his relationship with a film distribution company in which the fund he managed for the firm invested millions of dollars. For four years, BlackRock Multi-Sector Income Trust (BIT), invested in subsidiaries of Aviron Group, LLC, loaning them as much as $75 million to fund advertising of motion pictures. Robertson, a co-portfolio manager of BIT played a significant role in recommending and overseeing BIT's loans to the Aviron subsidiaries. Robertson asked the founder of Aviron and another senior executive of the firm, who had influence over casting decisions in movies, to assist his daughter in advancing her acting career. Ultimately the Aviron executive was able to procure a role for her in a film in which Aviron had distribution rights and had been approved for potential financing by BIT. The Aviron executive also arranged for her to meet with other casting agents. Robertson did not disclose to BIT's board of trustees or to BlackRock's compliance and legal team that he asked Aviron's assistance in providing his daughter with a film role or in advancing her acting career. The SEC found Robertson's actions to violate Section 206(2) of the Advisers Act which prohibits an investment adviser, directly or indirectly, from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. To settle the matter, Robertson agreed to a cease-and-desist order, a censure, and a $250,000 penalty.

SEC Press Release – https://www.sec.gov/news/press-release/2023-3

Financial Statement & Audit Failures

Private Fund Auditor Improper Professional Conduct (March 29, 2023)

Spicer Jeffries LLP, an audit firm, and Sean P. Tafaro, an audit engagement partner, settled SEC charges for their improper conduct in connection with audits of private funds. The SEC alleged that during the audit planning stages, Spicer Jeffries and Tafaro identified valuation of investments as a significant fraud risk but then failed to implement the planned audit approach to respond to the risk. They failed to obtain audit evidence about the method of measuring fair value, the valuation models, and whether alternative valuation assumptions were

considered. Due to these omissions, they were charged for failure to exercise due care including professional skepticism. The quality control deficiencies were deemed failures to adhere to professional auditing standards. Spicer Jeffries and Tafaro consented to the finding of improper professional conduct and agreed to be censured and to implement undertakings to retain an independent consultant to review and evaluate their audit, review, and quality control policies and procedures. Tafaro further agreed to a suspension from appearing and practicing before the SEC as an accountant, although he may apply for reinstatement after one year.

SEC Press Release – https://www.sec.gov/news/press-release/2023-65

Privacy & Cybersecurity

Inadequate Disclosure Regarding Ransomware Attack (March 9, 2023)

The SEC charged Blackbaud Inc., a public company that provides donor data management software to non-profit organizations, for making misleading disclosures about a 2020 ransomware attack that impacted more than 13,000 customers. Blackbaud announced to customers that the ransomware attacker did not access donor bank account information or social security numbers. However, the company's technology and customer relations personnel learned that the attacker had in fact accessed and exfiltrated this sensitive information. Employees withheld this information from Blackbaud senior management responsible for its public disclosures and the company did not have adequate controls or procedures to ensure that information relevant to cybersecurity incidents and risks were communicated to the company's senior management and other disclosure personnel. As a result, relevant information related to the incident was never assessed from a disclosure perspective. The company filed a report with the SEC that omitted material information about the scope of the attack and misleadingly characterized the risk of an attacker obtaining sensitive donor information as hypothetical. Because public companies have an obligation to provide their investors with accurate and timely material information, the SEC found Blackbaud in violation of Sections 17(a)(3) of the Securities Act, Section 13(a) of the Exchange Act and Rules 12b-20, 13a-13, and 13a-15(a) thereunder. Blackbaud agreed to cease and desist from committing violations of these provisions and to pay a $3 million civil penalty.

SEC Press Release – https://www.sec.gov/news/press-release/2023-48

SEC Subpoena of Law Firm for Names of Entities Impacted in Cybersecurity Breach (January 12, 2023)

The SEC is investigating potential violations of the federal securities laws arising from the Microsoft Hafnium cyberattack, including potential illegal trading and disclosure violations arising from the cyberattack. Threat actors associated with the Microsoft Hafnium cyberattack maliciously and unlawfully obtained access to multinational law firm, Covington & Burling LLP's computer network, individual devices, and non-public files of nearly 300 Covington clients that are regulated by the SEC. The SEC learned of the cyberattack and issued a subpoena soon afterward seeking the names of the clients whose files were viewed, copied, modified or exfiltrated by the threat actor. The SEC is seeking the information to assist in identifying any suspicious trading by the threat actors or others in those clients' securities. The SEC will consider whether trading was illegal based on material non-public information the threat actors viewed as part of the cyberattack. To date, Covington has refused to provide the names of the majority of clients, except for clients who have consented to providing their names to the SEC. The SEC's application seeks an order from the court directing Covington to show cause as to why they should not be compelled to produce the documents as required by the subpoena. The SEC application is subject to the court's ruling. The SEC is continuing its fact-finding investigation and, to date, has not concluded that any individual or entity has violated the federal securities laws.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/2023/lr25612.htm

Regulatory Updates and Enforcement

FCPA Violations

Rio Tinto Bribery Controls Failures (March 6, 2023)

The SEC announced charges against global mining and metals company, Rio Tinto plc. The charges arose out of a bribery scheme involving a consultant in Guinea. Rio Tinto hired a French investment banker, who was a personal friend of a former senior Guinean government official, as a consultant to help the company retain its mining rights in the Simandou mountain region in Guinea. The consultant was working on behalf of Rio Tinto without a written agreement and was paid $10.5 million. The SEC investigation uncovered that the consultant offered and attempted to make an improper payment of at least $822,000 to a Guinean government official in connection with the effort to help Rio Tinto retain its mineral rights. Further misconduct was discovered in that Rio Tinto's books and records failed to accurately reflect the payment. The SEC found that the company failed to apply internal accounting controls which would have detected or prevented the misconduct. The consultant's only ostensible qualification to serve in the role was his personal relationship with the Guinean government official. Rio Tinto consented to the SEC's order and agreed to pay $15 million in civil penalties for violating the books and records and internal accounting controls provisions of the Exchange Act.

SEC Press Release – https://www.sec.gov/news/press-release/2023-46

Due Diligence, Monitoring, Payment & Recordkeeping Failures (March 6, 2023)

Flutter Entertainment, an Ireland-based global gaming and sports betting company and the successor-in-interest to The Star Group, Inc. was charged by the SEC with books and records and internal accounting controls violations arising out of the company's use of third-party consultants in Russia. The company operated gaming brands, including the Poker Stars online poker website. During a five-year period when the company's shares were registered with the SEC, the company paid approximately $8.9 million to consultants in Russia in support of its operations and in efforts to have poker legalized in that country. During the same period, the company failed to devise and maintain a sufficient system of internal accounting controls over its operations in Russia with respect to third-party consultant. They failed to make accurate books and records regarding the payments. However, contemporaneous emails obtained in the investigation indicated the payments covered reimbursement for New Year's gifts to Russian government officials, which Company policies prohibited. The payments also included reimbursement of a consultant's payment to Roskomnadzor, the Russian state agency responsible for administering internet censorship filters in the country. The SEC order charged Flutter, as successor-in-interest due to its acquisition of the Company in May 2022, with violating Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act. Flutter agreed to a cease-and-desist order and to pay a penalty of $4 million. The SEC noted Flutter's cooperation, remedial efforts and subsequent withdrawal from the Russian market following Russia's invasion of Ukraine in 2022.

SEC Administrative Release – https://www.sec.gov/enforce/34-96719-s

Miscellaneous Enforcement

Failure to Disclose Perks and Payments (March 2, 2023)

Greenbrier Companies, Inc. a freight transportation supply company, and its founder and former Chairman, William A. Furman, were charged by the SEC for failing to disclose perks provided to Furman and other Greenbrier executives. The company was further charged with failing to identify and disclose compensation Furman received from Greenbrier's charters of Furman's private plane for travel by Furman and company executives. Furman owned a private plane which he leased to an aircraft management company to charter to third parties. During a five-year-period Greenbrier paid the management company approximately $3 million to charter the plane for business-related travel, but Greenbrier did not disclose that Furman received approximately $1.6 million of that amount. Greenbrier failed to disclose approximately $320,000 in perks provided to Furman and other executives for travel-related expenses for the executives' spouses to attend customer and industry receptions and other functions. Because public companies are required to disclose their executives' financial interest in company transactions and keep accurate record regarding perks, the SEC deemed the company's

omissions a violation of their transparency obligations. Greenbrier and Furman were found to have violated negligence-based antifraud and proxy provisions of the federal securities laws. Additionally, they were charged with keeping and reporting inaccurate books and records and failing to implement sufficient internal controls. Greenbrier and Furman agreed to cease and desist from future violations of the federal securities laws and pay $1 million and $100,000 in civil penalties, respectively.

SEC Press Release – https://www.sec.gov/news/press-release/2023-43

Private Fund Misrepresentations (February 27, 2023)

RIA, Foresight Wealth Management, LLC and its principal, Adam E. Nugent, settled SEC fraud charges for violations related to a private fund they managed. Foresight and Nugent raised approximately $19.5 million from over eighty investors, many of whom were individual advisory clients, through offerings of limited partnership interests and promissory notes in the private fund. The defendants defrauded the fund and its investors by misusing fund assets, failing to disclose conflicts of interest, misrepresenting to investors how the proceeds of their investments would be used, and breaching the fund's limited partnership agreement. While the fund offering documents disclosed that the fund would make investments in cannabis farming, processing, distribution and retail operations in California, the documents failed to disclose that fund proceeds would also be used to offset administrative, operational and organizational expenses related to the fund offering, and for the purpose of paying off prior loan transactions from individual investors who were advisory clients of the firm as well as Nugent and his personal friends to avoid losses. The defendants were found in violation of the antifraud provisions of Section 17(a) of the Securities Act; Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 as well as Rule 206(4)-8 thereunder. The firm and Nugent agreed to a cease-and-desist order, joint and several disgorgements of $1,379,061, prejudgment interest of $280,003, and a civil penalty of $1,379,061. Nugent agreed to an industry bar and an investment company prohibition.

SEC Administrative Release – https://www.sec.gov/enforce/33-11160-s

Form 13F Misleading Filings (February 21, 2023)

Ensign Peak Advisers Inc., a non-profit entity operated by The Church of Jesus Christ of Latter-day Saints (the ***Church***) to manage the Church's investments, was charged by the SEC for failing to properly file Form 13F from 1997 through 2019. Institutional investment managers are required to report in Form 13F the value of 13(f) securities they manage. Although Ensign Peak maintained investment discretion over all relevant securities, the adviser failed to file its own Form 13F to accurately disclose the Church's equity investments, but instead filed Forms 13F in the names of shell LLC entities thereby obscuring the Church's portfolio and misstating Ensign Peak's control over the Church's investment decisions. The Church was apparently concerned that disclosure of its portfolio, which had grown to approximately $32 billion, would lead to negative consequences. To obscure the actual amount, Ensign Peak, with the Church's knowledge and approval, created thirteen shell LLCs located throughout the U.S. and filed Form 13F in the names of the LLCs rather than in the name of Ensign Peak. Ensign Peak controlled the shell companies and directed "business managers," most of whom were employed by the Church, to sign the false Form 13F filings. The false Form 13Fs misstated that the LLCs had sole investment and voting discretion over the securities when, in fact, Ensign Peak retained control over all of the investments and voting decisions. Because the requirement to file accurate information on Form 13F applies to all institutional investment managers, including non-profits and charitable organizations, Ensign Peak was charged with violating Section 13(f) of the Securities Exchange Act and Rule 13f-1 thereunder. Ensign Peak settled the allegations by paying a $4 million penalty and the Church itself agreed to pay a $1 million penalty.

SEC Press Release – https://www.sec.gov/news/press-release/2023-35

Regulatory Updates and Enforcement

Violation of Whistleblower Protection Rule (February 3, 2023)

The SEC announced that Activision Blizzard Inc., a video game development and publishing company, settled charges for failing to maintain and disclose controls and procedures to ensure that the company could assess whether its disclosures pertaining to its workforce were adequate. For a four-year-period Activision Blizzard was aware that its inability to attract, retain and motivate employees was an important risk to the business, but it lacked controls and procedures among its business units to collect and analyze employee complaints of workplace misconduct. The SEC found that the firm failed to implement necessary controls, failed to collect and review employee complaints about workplace misconduct, and failed to gather sufficient information to understand and assess whether issues existed that would have required public disclosure. Additionally, Activision Blizzard executed employee separation agreements that violated the SEC whistleblower protection rule by requiring former employees to notify the company if they received a request for information from SEC staff. The firm was charged with violations of Exchange Act Rules 13a-15(a) and 21F-17(a) and agreed to settle the matter by paying a $35 million penalty.

SEC Press Release – https://www.sec.gov/news/press-release/2023-22

Other Regulatory Developments

Anti-Money Laundering & Sanctions Developments

FinCEN Issues Initial Beneficial Ownership Information Reporting Guidance (March 24, 2023)

In March 2023, the Financial Crimes Enforcement Network (***FinCEN***) published its first set of guidance materials to aid the public in understanding upcoming beneficial ownership information (***BOI***) reporting requirements taking effect on January 1, 2024. The new regulations require many corporations, limited liability companies, and other entities created in or registered to do business in the United States ("***reporting companies***") to report information about their beneficial owners—the persons who ultimately own or control the company—to FinCEN. Beneficial ownership reporting requirements, part of the Corporate Transparency Act, are intended to "unmask shell companies and protect the U.S. financial system from abuse by money launderers, drug traffickers, sanctioned oligarchs, and other criminals," according to Himamauli Das, Acting Director of FinCEN.

Key Beneficial Ownership Reporting Questions:

- **Who is required to comply as a reporting company?**
  - While certain types of entities are exempt, if a firm is a small corporation or LLC, it will likely be required to report your beneficial ownership information to FinCEN. Note, this potentially includes several categories of investment advisers that are not specifically exempted, including: 1) state-registered advisers; 2) all exempt reporting advisers (***ERAs***) that only file with a state regulator; and 3) non-venture capital fund ERAs with the SEC. In addition, this potentially may include certain private funds that do not satisfy the Section 3(c)(1) or 3(c)(7) exemption from registration under the Investment Company Act of 1940 (***Company Act***), as the exemption for pooled investment vehicles seems to only contemplate those private funds.
- **Who is exempt?**
  - SEC RIAs, venture capital fund advisers that have filed with the SEC as ERAs pursuant to Section 203(l) of the Advisers Act, pooled investment vehicles (including registered funds under the Company Act and private funds exempt from registration under Section 3(c)(1) or 3(c)(7)), and subsidiaries of certain exempt entities (including general partners and managing members of pooled investment vehicles), are among the 23 categories of entities specifically exempted from beneficial ownership information reporting requirements.
  - Other notable exemptions to reporting requirements include "large operating companies," which applies to companies that employ more than 20 employees on a full-time basis in the U.S.,

maintain an operating presence at a physical office in the U.S., and filed a U.S. federal income tax return for the previous year showing more than $5 million in gross receipts or sales from operations in the U.S.

- **Who is considered to be a beneficial owner?**
  - A beneficial owner is any individual who exercises substantial control over a company, or who owns or controls at least 25% of a company.
- **What information needs to be reported?**
  - A reporting company will need to provide: (1) its legal name and any trade name or DBA; (2) its address; (3) the jurisdiction in which it was formed or first registered, depending on whether it's a U.S. or foreign company; and (4) its Taxpayer Identification Number (TIN).
  - For each of a company's beneficial owners and each company applicant (if required), the company will need to provide the individual's: (1) legal name; (2) birthdate; (3) address (in most cases, a home address); and (4) an identifying number from a driver's license, passport, or other approved document for each individual, as well as an image of the document that the number is from.
- **When and how should my company file its initial report?**
  - Reporting companies created or registered before January 1, 2024, will have one year (until January 1, 2025) to file their initial reports, while reporting companies created or registered after January 1, 2024, will have 30 days after creation or registration to file their initial reports. Once the initial report has been filed, both existing and new reporting companies will have to file updates within 30 days of a change in their beneficial ownership information. FinCEN will accept reports electronically through a secure filing system available via its website beginning January 1, 2024. There will be no fee for submitting beneficial ownership information reports to FinCEN.
- **Who will be able to access reported beneficial ownership information and for what purposes?**
  - The Corporate Transparency Act authorizes FinCEN to disclose beneficial ownership information in certain circumstances to six types of requesters:
    - U.S. Federal agencies engaged in national security, intelligence, and law enforcement activities;
    - State, local, and Tribal law enforcement agencies with court authorization;
    - The U.S. Department of the Treasury;
    - Financial institutions using beneficial ownership information to conduct legally required customer due diligence, provided the financial institutions have their customer consent to retrieve the information;
    - Federal and state regulators assessing financial institutions for compliance with legally required customer due diligence obligations; and
    - Foreign law enforcement agencies and certain other foreign authorities who submit qualifying requests for the information through a U.S. Federal agency.

Additional guidance, including information on how to submit beneficial ownership information to FinCEN, is expected to be published in the coming months. Those with specific questions about the upcoming reporting requirements may contact FinCEN at https://www.fincen.gov/contact.

https://www.fincen.gov/news/news-releases/fincen-issues-initial-beneficial-ownership-information-reporting-guidance

Digital Asset Developments

General Crypto Market Developments

As the Federal Reserve Bank continues to raise interest rates with limited impact on inflation, Bitcoin, Ether, and other more established cryptocurrencies are off to a volatile, yet positive start to 2023. Bitcoin closed 2022 at

$16,500/coin and climbed to $28,500/coin on March 31, 2023. Ether finished 2022 at $1,200/coin and rebounded to $1,800/coin at the end of March 2023. Crypto proponents are boasting the year-to-date performance of the major cryptocurrencies while crypto-skeptics are highlighting the importance of comparing the recent rally with the all-time-high prices (Bitcoin: $67,500/coin, Ether: $4,900/coin). The crypto market is impacted by different factions with diverse sentiments including those who are die-hard believers in crypto who generally never sell, known as "HODlers" or those who "hold on for dear life." On the other end of the spectrum are big institutions who, after the various crypto scandals and collapses, such as FTX, Terra and Celsius, are keeping their hands, and more importantly their deep pockets, out of anything that pertains to crypto.

Nevertheless, crypto still represents a meaningful portion of the investment marketplace as one in five Americans has reportedly invested in, traded, or used cryptocurrency in the last five years. Regulators and the media are still contemplating the best way to effectively regulate crypto markets, with gradual updates to the existing regulatory framework to address such assets. Recent proposed amendments by the SEC would expand the Advisers Act Safekeeping (Custody) Rule to specifically address digital assets, as noted above. The National Futures Association (***NFA***) recently adopted a compliance rule which imposes anti-fraud, just and equitable principles of trade, and supervisions requirements on NFA members and associates that engage in digital asset commodity activities. (See https://www.nfa.futures.org/rulebooksql/rules.aspx?Section=4&RuleID=RULE%202-51).

There some who are reluctant to advocate for more regulation, as they believe that doing so would grant credibility and legitimacy to these volatile and risky companies and investments. However, disavowing cryptocurrencies and Blockchain technology might prove short-sighted as the investment landscape and technology continues to evolve at a rapid pace. At the moment, investors should be mindful that investing in crypto assets is a high-risk proposition, as the crypto market is still in its infancy and regulation has not fully caught up.

https://www.theguardian.com/tv-and-radio/2023/apr/24/john-oliver-cryptocurrency

SEC Charges Crypto Trading Platform Beaxy and its Executives for Operating an Unregistered Exchange, Broker, and Clearing Agency

In March 2023, the SEC charged the cryptocurrency trading platform Beaxy and its executives with operating an unregistered exchange, broker, and clearing agency, thereby violating federal securities laws. Beaxy failed to register the platform with the SEC and failed to comply with other regulatory requirements according to the SEC complaint. Beaxy facilitated the buying and selling of digital asset securities without proper registration or obtaining an exemption from registration. The SEC alleged that Beaxy acted as an unregistered broker by connecting buyers and sellers and earning commissions on transactions. The SEC further alleged that the trading platform acted as an unregistered clearing agency by providing services related to the confirmation, settlement, and delivery of digital asset securities.

The charges highlight the need for cryptocurrency trading platforms and other market participants to comply with federal securities laws, including registration requirements, in the United States. SEC Chair Gary Gensler said, "Our securities laws for decades have served to protect investors, make capital formation easier and cheaper, and improve our markets. This case serves as yet another reminder to crypto intermediaries that their business models must comply and adapt to the law, not the other way around."

SEC Press Release – https://www.sec.gov/news/press-release/2023-64

SEC Charges Crypto Entrepreneur Justin Sun and his Companies for Fraud and Other Securities Law Violations

Also in March 2023, the SEC announced charges against crypto asset entrepreneur Justin Sun and his three companies, Tron Foundation Limited, BitTorrent Foundation Ltd., and Rainberry Inc., for violating securities laws through the unregistered sale of crypto asset securities, Tronix (***TRX***) and BitTorrent (***BTT***). Additionally, the companies were charged with fraudulently manipulating the secondary market for TRX through wash trading.

Simultaneously, the SEC charged the following eight celebrities for illegally touting BTT and TRX without disclosing that they were compensated for doing so or the amount of their compensation: Lindsay Lohan, Jake Paul, DeAndre Cortez Way (Soulja Boy), Austin Mahone, Michele Mason (Kendra Lust), Miles Parks McCollum (Lil Yachty), Shaffer Smith (Ne-Yo) and Aliaune Thiam (Akon).

SEC Press Release – https://www.sec.gov/news/press-release/2023-59

Recent Trends in Enforcement Cases

Enforcement cases involving digital assets have been on the rise in recent months as regulatory agencies have stepped up efforts to crack down on fraudulent and illegal activities in the crypto space. Following are key trends in digital asset enforcement cases:

- Unregistered Securities Offerings: Many enforcement actions have focused on unregistered securities offerings, which violate the Securities Act. Companies have been charged with offering and selling digital tokens or coins that meet the definition of a security without properly registering them with the SEC.
- Fraud and Misrepresentation: Fraud and misrepresentation continue to be crucial issues in digital asset enforcement cases. Companies have been charged with making false or misleading statements about their products, services, or financial conditions, or with failing to disclose important information to investors.
- Market Manipulation: Market manipulation has also been a significant problem in digital asset enforcement cases. Companies have been charged with engaging in manipulative trading practices such as wash trading and spoofing to inflate the prices of their digital assets.
- Airdrops and Bounty Programs: The SEC has also been targeting airdrops and bounty programs, which are used by companies to distribute digital assets to participants in exchange for performing certain activities. If these programs involve the distribution of securities, they must comply with SEC registration and disclosure requirements.
- Celebrity Endorsements: Celebrity endorsements have been a growing concern in digital asset enforcement cases. Celebrities have been charged with illegally promoting digital assets without disclosing that they were paid to do so.

Overall, the SEC and other regulatory agencies are taking a more aggressive approach to digital asset enforcement, signaling a shift toward greater scrutiny and oversight of the crypto industry. Companies operating in the space should take note of these trends and ensure that they are compliant with all applicable laws and regulations.

Privacy Law Developments

Several new states have proposed comprehensive consumer privacy and data privacy laws in 2023. Other states with existing consumer privacy legislation added additional legislative proposals that would supplement existing or add new privacy laws applicable to consumers and other individuals whose data is processed in connection with the state. Iowa passed its data privacy law in March 2023, as described below with an effective date of January 2025. Indiana, Montana, and Tennessee have each passed their anticipated versions of such laws after quarter-end but prior to the date of publication, with each slated to go into effect or require compliance over the course of 2023-2025. These laws as well as other new proposals from the second quarter will be summarized in the Q2 Regulatory Update. In many cases the laws are tailored to provide exemptions for private information or entities covered by federal provisions, such as investment advisers and data covered by GLBA or Reg S-P.

While exclusions for data subject to Reg S-P are still widely available, the protections of Reg S-P and GLBA do not extend to all private data that may be covered by state laws. If an RIA or ERA otherwise meets a state's applicability thresholds and is subject to its consumer protection law, the firm must consider its obligations under

state law noting that only certain personal data may be excluded by the Reg S-P or GLBA carve-outs. Exclusions vary among states.

In the U.S. legislature, Congress held a hearing in March 2023 in which it moved to revisit the American Data Privacy and Protection Act (***ADPPA***). A federal privacy protection statute, if passed, could preempt many of the state laws already enacted or in progress.

Following is a selection of recent and upcoming state privacy and data protection developments.

California

California Consumer Privacy Act & California Consumer Privacy Rights Act Updates

New or expanded California privacy acts went into effect in January 2023 and California continues to propose additional rules in this area. Additional rulemakings are still expected, according to recent proceedings and statements from the California Consumer Protection Agency (***CCPA***) and Attorney General. The first set of regulations has been proposed and the CCPA's Q1 2023 agendas indicate comments and revisions to the original regulations are still underway. These regulations are expected to be final in the first half of 2023. Preliminary discussions related to new regulation proposals, in the areas of cybersecurity and risk-assessment regulations for certain data processors, are already on the agendas for 2023. The California Consumer Privacy Rights Act provides for enforcement beginning July 1, 2023, for violations occurring on or after that date.

Illinois

In February 2023, the Illinois House of Representatives proposed the Data Privacy and Protection Act (***IDPPA***) to bolster its already stringent consumer and data privacy protection regime. The IDDPA is modelled after the federal ADPPA, and similar to Illinois' prior data privacy breach law, the IDPPA would broadly apply to any "covered entity" that establishes its means of collecting, processing, or transferring "covered data." Covered data is broadly defined to include anything (other than public, employee, or "de-identified" data), identifying or "linkable" to information reasonably identifying an individual who is an Illinois resident or within the state of Illinois. Further, as written, the law does not exclude data or entities subject to GLBA or any other federal laws. This proposal, if passed, would likely impact most businesses with sufficient connections to the state of Illinois or its residents, including RIAs and ERAs. Based on the text of the bill as introduced in February, the key requirements, obligations, and implications are:

- Privacy by Design Principles – Limiting a firm's use of covered data to only that which is reasonably necessary and proportionate, which is generally described as what is needed to provide a product or service requested by the individual or effect one of a series of enumerated processes (*e.g.*, authentication, compliance with legal obligations, fulfilling warranties, etc.).
- Duty of Loyalty – The proposal imposes a duty on covered entities processing "sensitive covered data," a smaller subset of covered data (*e.g.*, Social Security Numbers)
- Policies & Procedures – Covered entities and service providers must establish policies and procedures surrounding data collection, processing, and transfer activities.
- Security Program – Firms must implement reasonable securities practices, including risk and vulnerability assessments, and defined data retention and disposal schedules for covered data.
- Consumer Privacy Rights – Consumers are provided the rights to access their personal data as well as information about data transferred to third parties, the rights to correct their personal data, request deletion, and obtain a portable copy of their data.
- Pre-Transfer Consent – Covered entities must obtain individual consent prior to transferring personal data to a third party or delivering targeted advertising.

- State Attorney General & Private Suits – The proposal authorizes the Attorney General as well as any municipal attorneys general to bring civil actions to enforce the act. It also provides a private right of action for individuals (excluding small businesses).
- Biennial Impact Assessments – Except for small businesses, covered entities would be required to conduct an assessment of all data processing activities that may cause substantial privacy risk. This assessment requirement may be of limited applicability to many RIAs and ERAs in that small business means the covered entity (i) had average annual gross revenues during the period did not exceed $41,000,000; (ii) did not annually collect or process the covered data of more than 200,000 individuals; and (iii) is not a data broker processor.

RIAs, and ERAs with robust compliance programs, may already have privacy policies, procedures and practices that are consistent with proposed IDPPA requirements, or they may otherwise be exempt from certain proposed requirements.

https://www.ilga.gov/legislation/103/HB/PDF/10300HB3385lv.pdf

Iowa

Iowa passed the Iowa Data Privacy Law in March 2023, which goes into effect on January 1, 2025 and applies to entities that conduct business in Iowa or produce products or services that target consumers in the state. Iowa defines "consumer" as a natural person who is a resident of the state acting in a noncommercial and nonemployment context. A business falls within the scope of the Iowa law if it controls or processes personal data of at least 100,000 Iowa consumers during a calendar year. Alternatively, businesses that derive more than 50% of gross revenue from the sale of personal data fall within scope of the law if they control or process personal data of at least 25,000 Iowa consumers. The Iowa privacy law does not apply to financial institutions, their affiliates and entities subject to the GLB.

https://governor.iowa.gov/press-release/2023-03-28/gov-reynolds-signs-sf-75-and-sf-262-law