CORE REGULATORY FORUM

Q2 UPDATE

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Regulatory Deadlines

- Form D – 15 Days after First Sale
- Schedule 13D/G – 10 Days after Triggering Transaction
- Form 13H – Promptly if mid-quarter changes
- Form 13F – August 14
- Form PF Large HF – August 30
- Advertising Rule Compliance Date – November 4

Notable News Headlines

- Are We In Recession Yet? - **Forbes**
- Musk Sued by Twitter Investor Over Busted $44 Billion Deal – **Bloomberg**
- SEC lacks the IQ to investigate Coinbase's crypto listings says Michael Burry – **Techstory**

Upcoming Events

- CORE Guidance & FAQ: Amended Advertising Rule
- CORE Webinar: SEC Rulemaking Developments and the Impact to Private Fund Managers

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CORE-CCO
COMPLIANCE: OUTSOURCED RESOURCES AND EXPERTISE

Regulatory Updates and Enforcement

Introduction

The U.S. Senate confirmed Jaime Lizárraga and Mark Uyeda to serve as Commissioners for the Securities and Exchange Commission (***SEC***) on June 16, 2022, returning the SEC to a full slate of five Commissioners. Uyeda, a Republican, replaced Commissioner Elad Roisman, while Lizárraga, a Democrat, took over for Commissioner Allison Herren Lee. Uyeda has a long history as an SEC attorney and previously served in various roles at the agency, most recently as detailee to the Senate Banking Committee. Lizárraga joins the SEC having served for the past 14 years as a senior adviser to House Speaker Nancy Pelosi (D-Calif).

With or without its full slate of five Commissioners, SEC rulemaking has come fast and furious through the first half of 2022 and is expected to continue unabated for the reminder of the year. The SEC released its Spring 2022 regulatory agenda in June, outlining numerous additional rule proposals planned for the next five months. Commissioner Hester Peirce criticized the agenda as representing "flawed goals and a flawed method for achieving them." She strongly criticized the pace and nature of recent rulemaking, suggesting that instead of focusing on issues central to its mission, the SEC is focused on hot-button topics outside of its mandate. In a public statement, Commissioner Peirce cited letters representing multiple trade associations and a bipartisan group of 47 Congress members urging the agency to allow sufficient time for public comment. She suggested the agenda's timetables "reveal that the rush of radical rulemakings remains relentless, despite pleas from almost every type of market participant and other interested party that the Commission slow down so that the public can catch up and provide meaningful input on our outstanding proposals." In contrast, Chairman Gensler applauded the agenda upon its release as an effort to ensure that regulation does not remain static in a dynamic society. In support of the agenda, Gensler stated "I'm driven by two public policy goals: continuing to drive efficiency in our capital markets and modernizing our rules for today's economy and technologies. Doing so will help us to achieve our three-part mission: protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation." Regardless which view readers may share, the coming months promise to bring significant changes that will impact CORE clients' regulatory and compliance programs.

Recent SEC Rulemaking

CORE expects numerous key rulemaking developments in the second quarter of 2022 to impact private fund managers and other institutional advisers directly or indirectly. Few rules have been finalized so far, but many new or amended rules have been proposed and are in their final stages. Some comment periods recently concluded, though others remain open. The SEC extended the comment period for several proposals, such as the proposed private fund rulemaking, and has received numerous comments on this and many others. Following are selected rulemaking developments and comment highlights for certain key proposals.

Form 13F, Confidential Treatment Requests & EDGAR Submission of Exemptive Requests

The SEC adopted amendments in June 2022 largely as proposed in November 2021, issuing a final rule that requires Requests for Confidential Treatment of Form 13F securities to be filed via the EDGAR system, as set forth in the EDGAR filer manual, rather than submitted by mail to the SEC. The final rule also includes certain minor or technical changes to the form and amendments to the Form 13F Confidential Treatment Instructions.

Minor amendments to the Form 13F include the option to use a Financial Instrument Global Identifier in addition to a CUSIP and a modification to Instruction 2.d of the Form 13F Confidential Treatment Instructions. The new Form 13F will also require a CRD number and SEC file number for the filer as well as related parties and sub-advisers. Technical changes to the form will require dollar amounts to be rounded to the nearest dollar, rather than the nearest one thousand dollars and the instruction to "omit the 000" will be removed (*i.e.*, a holding of $5 million will no longer be reported as "$5,000" due to character limitations). The 80 and 120 maximum character limits on the cover page and summary page will be removed. Further, certain definitions in the instructions have also been removed, determined to be duplicative.

Non-U.S. resident general partners and managing agents of SEC-registered investment advisers (***RIAs***) and exempt reporting advisers (***ERAs***) must file Form ADV-HR to appoint an agent for service of process in the United States. This form must now be filed electronically through the IARD system. Applicants previously had to submit paper applications and file paper notices of application in quintuplicate.

Applications for exemptive orders under the Investment Advisers Act of 1940 (***Advisers Act***) must be submitted electronically, via EDGAR, conforming the request process to substantially the same as that applicable to requests for exemptive relief under the Investment Company Act of 1940.

The changes regarding electronic order submissions and other filings, including Form 13F Requests for Confidential Treatment, will be effective mid-September 2022. There will be a six-month transition period, with a compliance date six months from the effective date.

Amendments to the Form 13F will be effective January 3, 2023. All filers will use the amended version of the form beginning on that date.

SEC Final Rule – https://www.sec.gov/rules/final/2022/34-95148.pdf

ESG Disclosures for Investment Advisers

In May 2022, the SEC proposed amendments to its disclosure and reporting rules applicable to private funds, registered investment companies, unit investment trusts, and business development companies that consider environmental, social, and governance (***ESG***) factors in their investment strategies, and investment advisers marketing such investment strategies. The proposed rule contemplates a "layered" disclosure approach and outlines three categories of ESG funds/strategies with a corresponding level of disclosure.

At a minimum, the rule would require advisers who consider ESG factors alongside other investment factors to amend Form ADV Parts 1A and 2A to reflect the ESG factors used and how they are incorporated into the investment process. Funds or advisers focused on ESG as a significant investment strategy or engaged in impact investing must make more detailed disclosures. In the case of registered funds, this means using prescribed form language and calculations in the prospectus/registration statement regarding how the funds use ESG metrics and data to accomplish stated ESG goals. The proposal also includes specific disclosures applicable to "impact" funds that use proxy voting or engagements to enact their desired impact, and additional reporting on greenhouse gas (***GHG***) emissions if a fund considers environmental factors in investing.

The amendments generally apply to any funds that "consider ESG factors" in their investment process and investment advisers marketing such funds or strategies. The proposal identifies three categories and applicable disclosures/reporting:

- Integration: Funds or advisers that consider ESG as a factor alongside other investment decision factors, would be required to disclose the ESG factors and how they are incorporated into the investment process.
- ESG-Focused: Funds or advisers for which ESG is the main or a significant consideration would be required to make a minimum specific disclosure. For certain registered funds, this would include disclosures in a standardized ESG strategy overview table in the prospectus/registration statement and annual reports.
- Impact: Funds that seek to achieve a particular ESG impact must abide by the disclosure rules for ESG-Focused Funds and, as applicable, advisers must make the below-described streamlined Form ADV disclosures. This category also requires additional disclosures regarding the impacts the fund or adviser seek to achieve as well as the use the proposed "key" metrics to assess their progress. Impact Funds are a subset of ESG-Focused Funds.

The proposal layers additional disclosure or reporting requirements onto the above categories:

- Impact Fund Proxy Voting and Engagements. Funds or advisers using proxy voting or engagement as a mechanism to achieve ESG impacts must further disclose information about their particular ESG-related proxy voting and ESG engagements.
- Greenhouse Gas Emissions Reporting. Funds focusing on environmental factors must disclose the greenhouse gas emissions associated with their portfolio investments.

As proposed, the rules provide substantially the same ESG categories for advisers to private funds as the categories provided for registered funds. Advisers would make "streamlined" disclosures in the Form ADV Parts 1A and the Part 2A brochure, as applicable, in Item 8: Methods of Analysis, Investment Strategies and Risk of Loss, Item10: Other Financial Industry Activities and Affiliations, and Item 17: Voting Client Securities.

An adviser to a private fund or a separately managed account, whether a RIA or an ERA would be required to note its ESG category, as well as the use of proxy voting and any "ESG affiliates" it uses on the Form ADV Part 1A. An RIA must also provide the "streamlined" disclosures in its Part 2A brochure. For example, a new sub-Item 8.D instructs the adviser to describe the ESG factor or factors it considers for each "significant investment strategy or method of analysis for which the adviser considers any ESG factors" and "how they incorporate these factors when providing investment advice." A "significant investment strategy" has the same meaning as on the Form ADV Part 2A; that is, "a method of analysis or strategies that will be relevant to most clients."

The proposal does not define "ESG" or similar terms, though the SEC has requested comments on this approach.

Though at least fifty comment letters have been submitted, to date the majority of published comments are submissions by individuals or industry and academic professionals focused on the climate change broadly or the particular GHG reporting metrics and methodology proposed. The comment period closes August 16, 2022.

SEC Press Release – https://www.sec.gov/news/press-release/2022-92

Investment Company Names Rule

A contemporaneous proposal under the Investment Company Act of 1940, "Amendments to the Names Rule," complements the ESG rule proposal. The Names Rule, which was originally adopted in in 2001, requires any registered fund with terms suggesting the fund has particular characteristics to adopt a policy to invest 80 percent of its assets in the investments suggested by that name. As proposed, the new names rule would prohibit funds that consider ESG alongside, but not more centrally than other, non-ESG factors, from using "ESG" or similar terminology in their name.

Again, the proposal does not define "ESG" or similar terms. However, both the investment adviser ESG disclosure proposal and the names rule proposal mention names such as "Impact," "Social, "Clean," "Responsible" and "Environment" as names the SEC used when researching its ESG rulemaking approach.

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/33-11067.pdf

Form PF Amendment Comments

In January 2022, the SEC considered proposals to amend Form PF, which would require immediate reporting for certain events that may present risks or material implications to fund investors or indicate systemic risks. The amendments would further require additional reporting for large private equity (***PE***) and large liquidity funds and would lower the threshold for large PE funds from $2 billion to $1.5 billion. The comment period ended in March 2022 with more than 120 comments letters received and multiple meetings between SEC officials and industry representatives, continuing through July. The views expressed in comment letters varied and in some cases were directly contradictory.

Many letters were from individuals or their representatives criticizing the lack of visibility into private fund's investments, suggesting self-dealing and other improprieties as a result of such opacity, and urging the SEC to promptly pass the amendments and increase transparency. For example, a letter from Public Citizen, a group

representing more than 500,000 members and supporters, highlighted the growth of private funds and expressed concern regarding the use of leverage in private funds and systemic risk created to the financial system, quoting statistics from Elizabeth Warren's website regarding bankruptcy rates of companies owned by private funds. The letter noted the sparsity of information required in Form PF for most private funds and encouraged additional disclosure requirements, particularly related to extraordinary investment losses.

Institutional investors and their representatives, *e.g.*, the Institutional Limited Partners Association (***ILPA***) generally supported the proposed reporting requirements and encouraged the SEC to require fund managers to share information from Form PF with their investors. However, the ILPA letter noted that a one-day reporting requirement for key events was unreasonably short and suggested a more practicable reporting timeline. Another letter recommended requiring PE funds to estimate liquidity by providing information regarding secondary market bid indications.

Fund managers and their representatives, in contrast to institutional investors, cautioned that the proposed requirements are overly broad, lack specificity, do not relate to systemic risk monitoring or protection of investors, require too frequent reporting, impose too short a timeframe for immediate reporting, and do not properly balance the costs of reporting with the potential benefits to investors, regulators, and the market as a whole.

Multiple commenters noted that the comment period (51 days for a 236-page proposal with 120 requests for comment) was too short and requested additional time to compile and prepare a response. For example, the Alternative & Direct Investment Securities Association (***ADISA***) noted in its letter that with more time, it could "identify which elements represent regulatory overreach or that appear to promise more burdens than benefits." In the absence of more time, ADISA submitted, "the SEC should postpone moving forward with these reporting initiatives until it can both justify the requirements and show how they will not unduly impair the ability of advisers to private funds to manager [sic] them as described in their disclosure materials."

Given that Form PF is a joint form utilized by multiple regulators under the Financial Stability Oversight Counsel, we expect that the proposed rule will not be quickly finalized.

Comments Received – https://www.sec.gov/comments/s7-01-22/s70122.htm

Private Fund Rulemaking Comments

The SEC proposed significant new rules for private fund managers in February 2022. These rules would require, among other things, that private fund managers provide standardized quarterly reporting to investors on fees, expenses, and performance, as well as mandatory fund audits, fairness opinions with respect to adviser-led secondary transactions, and additional disclosures with respect to side letter provisions. The rules would also prohibit preferential liquidity or transparency. The proposal drew over 200 comment letters and resulted in more than 30 meetings between SEC officials and industry representatives. The SEC extended the comment period through mid-June after much pushback that the original April period was too short. While many commenters supported enhancing transparency and providing meaningful disclosure to investors, numerous revisions and alternate approaches to rulemaking were proposed in response to aspects of the rule commenters thought problematic. In a rare consensus on both sides of the aisle, institutional investor groups and fund managers alike criticized the proposal for the same or similar reasons.

Many commenters, including fund managers, institutional investors, and their respective representatives, criticized the proposed rules as representing a radical departure from what should be a principles-based approach to regulation relying on full and fair disclosure plus effective steps to mitigate conflicts of interest. These commenters also generally agreed that instead, the rules imposed improper prospective requirements on existing agreements and prohibitions on existing and future agreements between advisers and the sophisticated investors in private funds and impeded their ability to independently negotiate.

Fund managers and their representatives raised additional legal and constitutional objections, arguing that: (i) the SEC lacks authority to promulgate the proposed rule; (ii) the proposed rule is impermissibly retroactive; (iii)

the proposed rule is inconsistent with the Advisers Act; and (iv) the SEC provided insufficient justification for the rulemaking.

Numerous prominent institutional investors and their representatives (ILPA and others) also commented. Like fund managers, many objected to various provisions in the proposal. In particular, investor groups objected to restrictions on side letter terms and other requirements they believe would interfere with their ability to negotiate contractual terms with private fund managers. Institutional investors further noted that the proposed rule would negatively impact emerging managers and thus have unintended consequences for institutional investors, such as additional costs, curtailment of investment and co-investment activity, limited access to performance information utilized in due diligence, and others.

Whether in principle or because of their potential unintended consequences, both investors and fund managers objected to the provisions that addressed: (i) limitations on adviser's liability; (ii) reducing adviser clawbacks for taxes; (iii) preferential treatment; (iv) allocation of co-investment costs and expenses on non-pro rata basis; (v) prohibition on passing through certain costs and expenses; and (vii) grandfathering, among others.

We expect that adoption of a final rule will be delayed as a result of the extensive comments and widespread pushback on the scope, workability, and implementation of the proposed rule.

Comments Received – https://www.sec.gov/comments/s7-03-22/s70322.htm

Cybersecurity Risk Management Comments

In February 2022, the SEC proposed new rules that would require RIAs and registered investment companies to adopt and implement written cybersecurity policies and procedures and a comprehensive cybersecurity risk management program mandating cybersecurity risk assessments and specific contractual provisions with service providers. It also mandated that those advisers' programs to address threat and vulnerability management. The guidance would further require immediate reporting to the SEC within 48 hours in the event of a security breach as well as further disclosure to clients and investors of cybersecurity risks and incidents. The SEC received more than 60 comment letters on the proposed rulemaking and conducted multiple meetings with industry participants.

Commenters were generally in favor of additional controls and protections to combat the increase in cybersecurity risks and incidents. However, they expressed concerns that advisers, also potential victims in a cybersecurity incident, would be exposed to fraud liability as a result of other parties' misconduct.

In addition, commenters felt the proposed rule was inconsistent with principles-based regulation and that it was too prescriptive and inflexible, particularly given the rapid developments in cybersecurity frauds. Commenters requested and suggested greater flexibility in how advisers and funds implement cybersecurity risk management programs.

Commenters also expressed concern that the definitions of "cybersecurity threat" and "significant fund cybersecurity incident" are overly broad and would require unnecessary and expensive reporting.

Further, other commenters argued that requiring public disclosure of security incidents could create additional risk that would be detrimental for funds, advisers, their clients and investors.

Finally, commenters noted that 48 hours was an insufficient amount of time for required reporting of cybersecurity incidents to the SEC and that the timeframe should be extended to at least 72 hours.

We expect this rulemaking to move forward but with some modifications to address the concerns that were raised. Commenters requested a sufficient compliance period (*e.g.,* 18-36 months) to ensure an effective and orderly implementation.

Comments Received – https://www.sec.gov/comments/s7-04-22/s70422.htm

Short Sale Disclosure Comments

In February 2022, the SEC proposed a new rule under the Securities Exchange Act of 1934 (***Exchange Act***) in an effort to provide greater transparency to investors and regulators by increasing the public availability of short sale-related data. The proposed rule would require institutional investment managers exercising investment discretion over short positions meeting specified thresholds to report on Form SHO within 14 calendar days after the end of each month information relating to end-of-the-month short positions and certain daily activity affecting such short positions. The SEC would then aggregate the resulting data by security and publicly disseminate it while maintaining the confidentiality of reporting managers. The SEC further proposed a related amendment to Reg SHO that would require broker-dealers to mark a purchase order as “buy to cover” if the purchaser has any short position in the same security at the same time the purchase is entered. The SEC received nearly 300 comment letters on the proposed rulemaking and held several meetings with industry participants. Comments were received from many retail investors as well as public company issuers, broker-dealers and their representatives, exchanges, and fund managers and their representatives.

Most retail investors favored the new rules. Many were critical of short selling abuses, risks related to naked shorting, and lack of transparency available to retail investors, and favored a requirement that shorts should only be covered by a purchase.

Public company issuers noted the need for regulation to defend against short-seller bad actors and address short sale predation involving baseless short sale speculation and manufactured market manipulation. These and other commenters noted that the proposed rulemaking does not adequately require disclosure for short position holders other than institutional managers.

Broker-dealers and their representatives noted that the new proposals would be costly and create operational burdens and risks that did not appear justified by the potential benefits. Institutional investors similarly expressed concern that the proposed reporting would be costly, burdensome, and duplicative, and would not necessarily provide additional information to improve market oversight or enable the SEC to timely respond to future market events.

Moreover, these commenters noted that the proposals could have unintended negative consequences, including discouraging short selling, which they argued is beneficial for market efficiencies, and negatively impacting securities lending practices, which is a significant revenue source for mutual funds, pension funds and other market participants. These commenters recommended that the requirements should be scaled back for managers with limited short selling activity and gave several suggested methods to do so, for example raising reporting thresholds or implementing dollar-based thresholds, requiring reporting based on net rather than gross exposure, excluding hedged short positions, limiting reporting requirements to stocks of U.S. reporting issuers, excluding exchange-traded funds, extending the timeline for reporting and others methods.

Institutional managers emphasized their concerns that publishing data on individual managers, rather than aggregated data, may facilitate reverse engineering of their trading strategies and urged controls to protect confidential manager-level position and trading data. Both investment managers and data providers questioned the way in which short sale-related data is currently collected and disseminated, noting that SEC should focus on more effectively utilizing information that is already available.

We expect that the SEC will take time to fully consider comments.

Comments Received – https://www.sec.gov/comments/s7-08-22/s70822.htm

Exam Developments

In May 2022, Richard Best was officially appointed as Director of the SEC’s Division of Examinations (***Exam Division***) from his prior role of Acting Director, to which he was appointed in March 2022. Mr. Best is an attorney, like many other SEC staff members, and previously served as Regional Director in the SEC’s New York, Atlanta and Salt Lake City Regional Offices. Prior to joining the SEC in 2015, he worked for the Financial Industry

Regulatory Authority (***FINRA***). He also spent approximately 10 years as a prosecutor in the Office of the Bronx County District Attorney, where he handled and supervised high-profile public integrity and organized crime prosecutions, among other matters.

SEC examination staff continued to work and actively conduct examinations remotely throughout the second quarter of 2022. For private funds, we expect continued focus on the areas noted in the SEC's 2022 Exam Priorities, such as fees & expenses, investment allocations, disclosures, and information security & cybersecurity, to name a few. A detailed discussion of the 2022 Exam Priorities can be found in the previous issue of CORE's Regulatory Forum. We further expect SEC examiners to focus on priority areas identified in the following risk alert.

Risk Alert: Investment Adviser MNPI Compliance Issues

The Exam Division issued a Risk Alert in April 2022 containing "notable" deficiencies in advisers' policies and procedures intended to prevent the misuse of material non-public information (***MNPI***) under Section 204A of the Advisers Act and Rule 204A-1 (***Code of Ethics Rule***). A cornerstone of investment adviser codes of ethics, Section 204A requires both ERAs and RIAs to have policies prohibiting insider trading and procedures and controls reasonably designed to prevent insider trading and the misuse of MNPI. The Code of Ethics Rule requires RIAs to supervise affiliated personnel and implement policies requiring that supervised persons adhere to standards of business conduct reflecting the adviser's fiduciary obligations and federal securities laws and report, for certain supervised persons (*i.e., "*access persons"), personal securities transactions and holdings. The reports are intended to enable compliance staff to monitor for potential insider trading, conflicts of interest, and other risks.

Among the MNPI deficiencies noted were advisers' failure to maintain adequate policies and procedures addressing the use of alternative data. In the staff's view, advisers using "non-traditional" or "alternative data" sources did not adequately address the risk of exposure to MNPI or other legal issues that could arise when using those sources. In a footnote, the staff cited some specific examples of alternative data, such as information gleaned from satellite and drone imagery, analyses of aggregated credit card transactions, social media, internet search data, and consumer geolocation data, but noted more broadly that alternative data refers to the "many different types of information used in financial analysis beyond traditional financial statements, company filings, and press releases." The staff specified that advisers did not have policies and procedures contemplating: (i) an assessment of website terms and conditions, (ii) legal obligations related to the collection or provision of alternative data, or (iii) what to do when the adviser becomes aware of red flags about the sources of such data. The staff also observed that when advisers conducted due diligence on a source it was not documented, such that advisers were not able to demonstrate that their processes were followed consistently as opposed to ad hoc. Further, advisers did not consistently apply due diligence processes to all sources of alternative data, meaning that advisers did not have adequate systems to identify new sources of alternative data or identify existing sources needing re-assessment.

The risk alert contained a second category of MNPI deficiencies related to "value-add investors;" *i.e.*, clients or fund investors who are corporate executives or financial professionals. The staff observed deficiencies indicating firms did not have adequate policies and procedures to identify those value-add investors likely to be at higher risk for possessing or receiving MNPI, such as officers or directors of public companies, principals or portfolio managers at asset firms, investment bankers, institutional investors, and other key persons, and track the adviser's relationship with those investors.

Finally, expert networks are in the MNPI spotlight once again. The staff noted deficiencies in three areas consistent with prior SEC guidance and enforcement actions applicable when an adviser allows calls with experts who may be related to a public company or have access to MNPI. Previous SEC guidance recommends that firms allowing such calls should implement controls beyond those offered by the expert network service. The staff noted that advisers were not tracking and logging expert network calls, reviewing detailed call notes, or comparing supervised persons' trading activity in the publicly traded securities of companies in similar industries

to those discussed on the call, in order to ensure supervised persons are not receiving or trading on the basis of MNPI.

Regarding the Code of Ethics Rule, the staff noted several deficiencies related to access persons, reporting, and supervision. In many of these areas, the staff noted that adviser's code did not contain any provisions whatsoever reflecting the proper requirements under this rule. The staff found that advisers failed to properly define and identify access persons and require pre-approval before obtaining a direct or indirect beneficial ownership interest in public and limited offerings. It also found that some advisers did not ensure transaction and holdings reports were submitted and did not review submitted reports. Further, some firms failed to contemplate a process for assigning review of the Chief Compliance Officer's (***CCO's***) reporting to another member of the adviser, effectively permitting the CCO to self-review their own holdings and transaction reports. Some reports, the staff found, did not include the precise content required under the Code of Ethics Rule or were not made at the appropriate time, because the adviser's policies did not address the content or addressed it incorrectly. For example, some firms did not require access persons to report holdings and transactions in private placements and others failed to obtain written acknowledgements, initially or as amended.

Related to Code of Ethics Rule reporting, the staff noted that some advisers' codes of ethics did not provide for the maintenance of a restricted list or a prohibition on any trading in investments on the adviser's restricted list. The staff also noted instances where employees had traded in investments on the adviser's restricted list. Further, not all adviser codes incorporated procedures designed to ensure that investment opportunities must first be offered to clients before the adviser may act on them. The staff observed instances where employees traded ahead of adviser trades, at a better price, and in contravention of an adviser's code.

Some Code of Ethics Rule deficiencies may seem like harmless technical violations, but advisers should not expect examiners to take technical foot-faults lightly. First, since Section 204A and the Code of Ethics Rule both address MNPI and insider trading, a reporting failure may signal a broader issue to an examiner, prompting them to dig deeper. Second, for ERAs and RIAs to private funds, this risk alert corresponds directly to the areas the Exam Division prioritized for examinations as "significant focus areas" in its 2022 Exam Priorities. Alternative data was also noted in the 2020 Examination Priorities and in recent enforcement actions. The use of expert networks and the Code of Ethics Rule have been the subject of previous SEC enforcement actions and regulatory guidance and are areas in which the SEC expects firms to have established policies and procedures. Not only must ERA and RIA insider trading policies and codes be reviewed in light of new and changed business practices, but also in light of regulatory guidance over time. New and different sources of MNPI can be tracked and addressed in the policy, and appropriate controls implemented, but examiners will also review an adviser's program against suggested practices in prior SEC alerts and guidance to determine whether the adviser has considered the recommended practices.

SEC Risk Alert – https://www.sec.gov/files/code-ethics-risk-alert.pdf

Selected enforcement actions and guidance:

- *Risk Alert, Securities and Exchange Commission, Observations from Examinations of Investment Advisers Managing Private Funds (June 23, 2020)* (MNPI and Code of Ethics)
- *SEC v. Longoria et al., Civil Action No. 11-CV-0753 (JSR) (SDNY, 2011)* (Expert Networks)
- *In the Matter of App Annie Inc and Bertrand Schmitt, Administrative Proceeding File No. 3-20549, Litigation Release No. 93975 (Securities and Exchange Commission, Sept. 14, 2021)* (Alternative Data)

Enforcement Developments

The SEC Division of Enforcement (***Enforcement Division***) continues an aggressive pursuit of investigations and enforcement actions, seemingly undeterred by questions surrounding the authority of its in-house administrative law judges (***ALJs***) and the constitutionality of certain administrative tribunal proceedings arising from the Fifth Circuit decision *Jarkesy v. SEC* issued in May 2022, discussed in more detail below. In July, the SEC challenged the Fifth Circuit's ruling, asking the court to review the decision with a full panel of judges and arguing *Jarkesy*

creates uncertainty because it conflicts with a Ninth Circuit ruling, *Decker Coal v. Pehringer*, with respect to the use of ALJs by the U.S. Department of Labor. The following are selected summaries of the SEC enforcement actions and other cases from the second quarter of 2022.

SEC Enforcement and Other Cases

Fund Audit Failures – Corona Associates Capital Management, LLC (June 30, 2022)

In this case against an unregistered ERA and manager to a master-feeder private fund, the SEC charged the firm and its principals for making misrepresentations to investors regarding fund audits. Although ERAs are not subject to the SEC custody rule that generally requires fund audits, the firm represented in fund offering materials that fund financial statements were audited annually, that audited financial statements would be provided to investors, and identified fund auditors. The SEC found that while the firm made efforts to engage an auditor, they failed to actually do so and therefore financial statements were never audited nor provided to investors as promised. Instead, the firm simply provided investors with monthly and yearly statements showing their individual gains and losses on investments in the funds. The firm was ordered to pay a $50,000 penalty and the principals were ordered to pay $20,000 and $10,000 penalties.

SEC Press Release – https://www.sec.gov/enforce/ia-6062-s

Expense Allocations – Energy Capital Partners Management, LP (June 14, 2022)

In a matter involving co-investor fees and expenses pre- and post-deal, the SEC charged Energy Capital Partners Management LP (***ECP***), a New Jersey-based RIA to PE funds, with allocating undisclosed, disproportionate credit facility expenses to one of its existing funds.

ECP negotiated approximately $5.5 billion take-private deal on behalf of its Fund III, an existing fund. To provide assurances of the $5.5 billion price, ECP called capital from Fund III and raised the remaining balance through a combination of commitments from pre-deal co-investors and a bridge loan covering the difference. As planned, ECP raised additional capital from its new Fund IV as well as post-deal co-investors, which it intended to use to repay the bridge loan. In connection with the loan, the bridge facility charged approximately $27 million in fees which ECP initially attempted to allocate pro-rata among Fund III, the pre-deal co-investors, Fund IV, and the post-deal co-investors. After negotiating with the pre-deal co-investors, who argued they should not bear an expense from an obligation intended to support future capital raises because they had provided firm commitments, ECP agreed not to charge the pre-deal co-investors and allocated Fund III more than its pro-rata share of the expenses. The SEC charged that Fund III's governing documents "did not disclose" that the fund "would not be allocated its proportional share of such deal-related expenses," though the documents disclosed that the fund would allocate fund expenses "based on the relative investments and/or benefits derived among the ECP III Funds" and/or "in any manner determined to be equitable, in the good faith judgment of ECP." The SEC also charged that ECP neither sought advisory committee approval nor did it attempt to otherwise disclose that the fund would not be allocated the expenses pro rata, making the disproportionate allocation improper. Further, ECP was charged with inadequate policies and procedures, due to its allocation policy stating only that "ECP will allocate expenses charged to its private funds on a fair and equitable basis in accordance with the relevant fund partnership agreements."

ECP agreed to a censure, cease-and-desist order, and a $1 million civil penalty and voluntarily paid back over $3.3 million in expenses to limited partners.

This case reiterates SEC staff expectation that expenses related to a portfolio company transaction or investment should be allocated pro rata to all funds and co-investors that have or would have invested in the transaction, rather than allocated solely or disproportionately to the primary fund. The SEC's proposed private fund rule would similarly prohibit private fund managers from allocating expenses related to a portfolio investment on a non-pro rata basis when multiple funds or co-investors have invested or proposed to invest in the same investment.

SEC Press Release – https://www.sec.gov/news/press-release/2022-107

Regulatory Updates and Enforcement

Reg M Short Selling Violation – Weiss Asset Management LP (June 14, 2022)

Weiss Asset Management LP (***Weiss***) agreed to pay approximately $6.9 million to settle charges that it violated Rule 105 of Regulation M, which prohibits short selling an equity security during a restricted period (generally five business days before a covered public offering) and then purchasing the same security through the offering, absent an exception. Rule 105 applies regardless of the trader's intent and is intended to promote offering prices that are set by natural forces of supply and demand rather than potentially manipulative activity.

According to the SEC's order, Weiss violated Rule 105 on seven occasions between December 2020 and February 2021 when it unlawfully purchased stock in seven public offerings after selling short those same stocks. The violations occurred because Weiss "repeatedly miscalculated the restricted period and dismissed a number of red flags raised by its internal controls that suggested possible violations of Rule 105." Weiss had policies and procedures in place designed to detect possible violations of Rule 105, such as using an automated tool to check for short sales of securities in the previous five business days. In certain instances, the tool returned a "fail" result after identifying the short sales. Those results notwithstanding, Weiss "participated in the offering after the firm's legal department miscalculated the restricted period to begin with the filing of… [the] preliminary prospectus supplement, rather than five business days before the pricing of the offering." With respect to each of the seven offerings, Weiss' "compliance department also received a number of automatically generated daily and weekly exception reports that correctly identified the offerings at issue as ones that may violate Rule 105," but again "based on the miscalculation of the restricted period, the compliance department cleared the exceptions." Thus, Weiss continued to improperly participate in offerings of securities it had sold short during the five-business-day period prior to pricing.

Weiss' review of its policies and procedures revealed that it had misapplied the Rule 105 restricted period. After the review, Weiss "engaged in a number of remedial steps, including conducting a more than five-year review of its trading record, identifying all seven violations at issue, segregating and booking a reserve of the profits, conducting Rule 105 training for its staff, updating and revising its Rule 105 policies and procedures to prevent future violations, hiring a compliance advisor, and hiring additional full-time compliance personnel." Weiss promptly self-reported the seven violations to the SEC staff and "provided summaries and chronologies of key issues and events that significantly advanced the efficiency of the staff's investigation and conserved Commission resources." According to the press release, the order "highlights the significant remedial efforts undertaken by Weiss…and the cooperation it provided in the investigation."

Penalties included disgorgement of profits of $6,508,793, interest of $190,211 and a penalty of $200,000. In determining to accept the offer, the order indicated that the SEC considered remedial acts promptly undertaken by Weiss and its cooperation with the SEC staff.

SEC Press Release – https://www.sec.gov/news/press-release/2022-106

Valuation and Inflated Performance – Alphacentric Advisors LLC & Garrison Point Capital, LLC (June 3, 2022)

The SEC settled two administrative proceedings in June 2022 against AlphaCentric Advisors LLC (***AlphaCentric***) and its related sub-adviser Garrison Point Capital, LLC (***Garrison***), for compliance program failures in relation to portfolio security valuations, inflation of an investment company's net asset value (***NAV***), and misleading statements to investors in a private fund. AlphaCentric, adviser to AlphaCentric Income Opportunities Fund (Ticker: IOFAX), delegated responsibility for portfolio securities' pricing to the fund's sub-adviser, Garrison, pursuant to a sub-advisory agreement. The SEC found that AlphaCentric failed to supervise Garrison in its performance of pricing activities, failed to monitor Garrison's compliance with the fund's investment guidelines, and failed to confirm Garrison maintained sufficient controls in light of the fund's investment activities.

Garrison purchased "odd lot" bonds for the fund in 2015 and 2016, which traded at a discount to the institutional round lot bonds available in the market. At the time, odd-lot bonds comprised nearly 100% of the fund's holdings. The fund's administrator calculated daily NAV, and the fund approved a pricing service vendor for the administrator's use in marking portfolio securities to inform its daily NAV calculations. Garrison's policies and

procedures required it to review the security prices used by the administrator for daily NAV calculations and notify the administrator if the prices appeared incorrect. Garrison's policies also stated that it should ensure portfolio investments were recorded at fair value, defined as the "price received in the sale" of the asset under orderly market conditions. As disclosed to the fund's board and shareholders, the pricing vendor's bond marks were reference prices based on institutional round lots, which the pricing vendor generally defined as those bonds with at least $1 million current face value. The vendor did not publish marks for odd lot bonds. The fund held approximately 42 odd lot bonds which the administrator valued at round lot prices published by the pricing vendor for daily NAV calculations. The difference in round lot versus odd lot pricing resulted in a significant increase in each bond's valuation on or around the following business day. On average, the bonds had a first day "bump" of nearly 3%, significantly contributing to the fund's positive performance and reported returns in 2015 and 2016. Shortly thereafter, the fund experienced significant inflows after outperforming its benchmark index with a high ranking compared to other similar funds.

After the inflows, Garrison stopped purchasing as many odd lot bonds for the fund, but it used performance figures from 2015 and 2016 that benefitted from the odd lot mark-ups in its marketing materials and investor disclosures, without explanation that the source of the performance was round lot pricing on odd lot bonds no longer being purchased as regularly for the fund. In its letters to investors, Garrison disclosed that its fixed income investments performed well, "as shown by the [f]und's performance," but a majority of the fund's reported inception-to-date returns were attributable to markups of odd lot positions and that the fund's portfolio had otherwise appreciated little over that period. Marketing materials represented that Garrison sought less liquid or odd lot sizing "in exchange for enhanced yield." Garrison also told investors that purchasing odd lot bonds at a discount would result in higher long term returns over the course of the bond's life but did not disclose the fact that the initial "enhanced yield" captured by the day-one markup contributed to the fund's performance. Thus, per the order, Garrison suggested that the same return was sustainable or expected long term. In reality, once the bonds were priced, they traded at market rates and not a discount to the round lot price. The order noted that by omitting an explanation as to the source of the performance, Garrison's explanations were misleading. Further, in a webinar to investors, Garrison compared the fund's performance to its private strategy, suggesting that it was able to find "good values" for odd lot bonds" and investors could expect "four to eight percent 'all weather' returns" in part because, in its private strategies it had consistently generated 15-30 percent. However, Garrison did not explain that its private strategies had different pricing requirements and methods, nor that the "good values" were based on odd lot bonds valued at one-time round lot prices.

The fund's valuation procedures provided the administrator could challenge the pricing vendor's initial valuations following a review for reasonableness. In practice, over the course of the fund's inception through 2019, Garrison, as the fund's sub-adviser and portfolio manager, would reach out to the pricing vendor seeking upward price adjustments based, for example, on Garrison's view of market color or bond reference data, and copy the administrator. The fund's valuation procedures also required Garrison or AlphaCentric to "promptly inform" the valuation committee of unreliable valuation methodology and to "notify" the fund's valuation committee and actively seek a determination when it believed a security should be priced at fair value. The order notes that instead, Garrison generally "informed" or "copied" the administrator and in some cases members of the fund valuation committee.

When the vendor did not revise its marks based on market color, Garrison submitted bids to broker-dealers offering to purchase certain bonds held by the fund for a higher price, then submitted those to the vendor as its own. In several instances, the fund held the entire tranche of the bond and thus could not purchase additional bonds in the market. Garrison noted this to the vendor, giving other reasons for sending the bids. Nonetheless, the vendor informed Garrison in 2019 that going forward, "we will not be able to accept bids from a party who already owns these bonds."

From at least February 2018, Garrison forwarded its pricing bid submissions to AlphaCentric and the fund administrator. AlphaCentric generally did not respond to or analyze the submissions.

The order notes that Garrison, pursuant to its sub-advisory agreement, was to promptly notify AlphaCentric if prices appeared incorrect. As the order suggests, Garrison could not have followed its procedures, which required it to rely on the vendor's marks "only when it believes the marks were accurate and reflect fair market value," because it did not have a process to quantify or validate the impact of using round lot prices for odd lot bonds. The order also notes that AlphaCentric did not have policies and procedures to oversee Garrison's performance of its duties or the communications with the pricing vendor.

Further, according to the order, AlphaCentric did not reasonably implement its policies and procedures, which required it to review daily pricing of the fund's holdings for reasonableness, because it did not review the marks to conclude whether they represented fair value or "exit price" for odd lot securities that traded at a discount to institutional round lot securities. The SEC further charged that Alphacentric failed to adopt policies requiring it to be involved in the process for determining the fair value of fund holdings.

Alphacentric agreed to a censure, cease-and-desist order, and a $300,000 civil penalty. Garrison agreed to a $3.5 million civil penalty, in addition to a censure and a cease-and-desist order.

SEC Press Releases – https://www.sec.gov/enforce/ia-6040-s; https://www.sec.gov/enforce/ia-6039-s

FCPA Violations – Tenaris S.A. (June 2, 2022)

Tenaris S.A. (***Tenaris***), a global steel pipe and product manufacturer, agreed to pay over $78 million in disgorgement of profits, civil penalties, and prejudgment interest in connection with the alleged scheme of its subsidiary, Confab Industrial S.A. (***Confab***), Confab's agent, and a government official of Brazilian state-owned entity Petrobas. The SEC charged Tenaris with violations of the anti-bribery, books & records, and internal accounting control provisions of the Foreign Corrupt Practices Act (***FCPA***).

According to the order, a Petrobas government official agreed with a Confab agent to waive an international tender process for certain pipe and tube contracts, thereby giving Confab direct access to negotiations with Petrobas in exchange for 0.5% of Confab's profits. The official set up a Uruguayan shell company and associated bank account, into which various Tenaris-controlled or affiliated companies funded payments. To conceal the bribes, fake contracts were executed between the Uruguayan company and the Tenaris affiliated companies, for purported consultancy and advisory services. The various transactions by which bribe payments were routed in connection with Petrobas contracts were inaccurately reflected in Confab's books and records, which Tenaris consolidated for purposes of its SEC filings.

In settling on a civil penalty amount, the SEC considered that Tenaris previously consented to a Non-Prosecution Agreement with the Department of Justice (***DOJ***) and a Deferred Prosecution Agreement with the SEC as a result of alleged bribes the company paid in 2011 to obtain foreign business from a state-owned entity in Uzbekistan. In its order, the SEC also considered Tenaris' cooperation in the investigation and remedial efforts taken, such as terminating its Brazilian commercial agents and reducing its use of commercial agents worldwide. In addition to the monetary penalties, Tenaris agreed to a cease-and-desist order and to make periodic reports to the SEC on the status of its remedial efforts and the effectiveness of its anti-bribery and anti-corruption compliance program, among other things, for a two-year period.

Though FCPA cases are often prosecuted by both SEC and the DOJ, the DOJ closed its parallel inquiry into the Brazil matter without taking action against Tenaris.

SEC Press Release – https://www.sec.gov/news/press-release/2022-98

Undisclosed Conflicts of Interest – Virtua Capital Management, LLC et. al. (May 23, 2022)

The SEC settled an administrative proceeding in which it charged Virtua Capital Management, LLC (***Virtua***), adviser to commercial and PE real estate funds, and three named individuals, with breach of fiduciary duty and misleading investors in private funds. The charges stem from undisclosed, unconsented self-dealing and other conflict of interest transactions among Virtua's funds and between the funds and Virtua affiliates as well as

partially disclosed affiliate fees that the SEC found to be misleading to investors. The funds did not have a formal investor committee or other independent entity authorized to approve conflicts of interest on the funds' behalf.

Members of Virtua management, Quinn Palomino, founder and principal of Virtua, Jack D. Rose, Chief Global Strategist at a Virtua affiliate, and Derek Uldricks, former president and manager of Virtua, were each named individually in the order as directing the transactions to affiliates or advising the funds to invest in transactions that would benefit themselves or a Virtua affiliate. In its order, the SEC cited written communications of Palomino, Rose, and Uldricks regarding certain transactions as conduct which made it appear the individuals were potentially influenced by the capital needs of other affiliate-managed projects, personal consulting fees, or salaries. For example, Ms. Palomino directed the funds to send an affiliate "$40,000…to cover for [another affiliate's] fees… [that affiliate] will be using this to cover payroll this week." In another transaction, the order cited Rose's instructions to transfer as an investment $35,000 from the funds to an affiliate so that affiliate could pay its outstanding bill to a third-party entity Rose controlled. Thereafter, Rose instructed that company to "transfer $25,000 to my personal account when the [affiliate] dollars come in."

In addition to the personal interest transactions, Virtua also allegedly caused the funds to participate in debt investments which, while not inconsistent with their investment objectives, were extended multiple times past maturity at the direction of Virtua's management. In another transaction, the SEC charged that an undisclosed conflict arose from the funds' purchase of land from an affiliate priced using a hypothetical appraisal value which assumed the property had an approved and effective preliminary plan for development. In effect, the price at which the fund purchased the land was based on underlying conditions that had not yet fully occurred. Thus, according to the order, the fund bore the risks and costs that the condition would not be met.

The order alleged that Virtua's fund private placement memorandum (***PPM***) "gave the appearance" that investments in the funds would be sourced in the open market using "data base and opportunity monitoring capabilities" or by way of other investors or lending institutions but in practice, the funds were almost exclusively invested in projects that Virtua affiliates managed. Although not inconsistent with the funds' investment objectives, the order stated that the nature and magnitude of affiliate transactions and lack of disclosure presented significant undisclosed conflicts of interest and in some cases actually benefitted Virtua or its management personnel over the funds. The order cited three transactions as examples of conflicts that should have been disclosed to investors.

Virtua's PPM and operating agreements disclosed only some of the affiliates' service fees relating to projects in which its funds invested, but not others. The fees, which included loan guarantee fees, consultation fees, acquisition fees, and sales fees, were material, according to the SEC. The PPM discussed compensation that "may be paid to affiliates," and it directed the investor to an attached exhibit for an extended, detailed discussion of affiliate compensation. However, the exhibit table containing affiliate services and corresponding fees was incomplete. Early in the investigation, Virtua representatives testified they believed the disclosures were adequate. "Nevertheless," the order notes, "certain services…along with the resulting fees, were not included" and it references fees that were later added to Virtua's disclosures as evidence. The SEC's position was that Virtua made materially misleading statements to investors in private funds in violation of Advisers Act Section 206(4) because by including some fees and not others, the documents lead investors to believe that all relevant fees were disclosed.

The adviser was censured, ordered to pay a civil penalty of $150,000, and agreed to administer payments of $1,714,089 in disgorged profits and pre-judgment interest to affected investors. In their personal capacities, Ms. Palomino agreed to pay a civil penalty of $100,000, Mr. Rose $75,000, and Mr. Uldricks $60,000, within 10 days of the order's entry. The order further required that Virtua give a copy of the order to all investors—current and former—in Virtua's funds.

SEC Press Release – https://www.sec.gov/enforce/34-94967-s

Regulatory Updates and Enforcement

ESG Misstatements – BNY Mellon Investment Adviser (May 22, 2022)

BNY Mellon Investment Adviser (***BNYMIA***) agreed to an order of settlement after the SEC brought charges that BNYMIA misrepresented its inclusion of ESG in the investment process to mutual fund investors. The SEC alleged that BNYMIA represented to investors its sub-adviser's research process included an "ESG quality review" for "all investments made" in its Overlay Funds, a group of BNYMIA-managed mutual funds and that the adviser implied that all investments in those funds had undergone an ESG quality review when they had not. Though BNYMIA's ESG Principals mandated it, investment professionals could and did select investments that were not researched for ESG purposes. BNYMIA's ESG Principles mandated that for certain mutual funds, BNYMIA's "Sustainable Funds," all investments must undergo an ESG quality review at the time of investment or within 30 days thereafter. However, BNYMIA failed to disclose that individuals on the sub-adviser's investment team could and did select investments in the Overlay Funds that were not researched for ESG purposes and did not undergo an ESG quality review.

BNYMIA's Sustainable Funds' investment objectives, as stated in its prospectus, incorporated ESG as part of their principal investment strategy. These funds followed certain ESG-related criteria for investments in securities that "demonstrate attractive investment attributes and sustainable business practices, and have no material unresolvable environmental, social and governance (ESG) issues." The BNYMIA Overlay Funds, in contrast, did not have the same mandate and did not contain language of this type in their prospectuses. Instead, BNYMIA represented to investors and intermediaries in Requests for Production (***RFPs***) that "ESG considerations were part of the investment process" and in certain board minutes and RFP responses that "ESG quality reviews were part of the sub-adviser's research process. The Overlay Funds prospectuses contained similar statements. However, according to the order, the Overlay Funds' prospectuses were incomplete because they did not state that the sub-advisor could select portfolio investments that were not necessarily subject to that part of the research process.

BNYMIA's RFP responses generally described its sub-adviser as having an ESG focus since its inception in 1978 and noted that it had established a Responsible Investment Team focusing on ESG investment risks in 2004. The sub-adviser's ESG Principles required that the Sustainable Funds have an ESG quality review performed on all equities and corporate bonds either prior to or within 30 days after the investment was made. In July 2020, the sub-adviser changed its policy to require that the Overlay Funds also have an ESG quality review and score prior to or shortly after an investment was made. No reviews were performed on some of the existing investments in the portfolio, those that the sub-adviser had elected not to perform the review on, in accordance with its policies in place at the time of investment. Overall, in March 2021, unscored investments comprised approximately 25% of the Overlay Funds' net assets.

From September 2018 to September 2021, BNYMIA represented to investors via the "goal and approach" section of its Overlay Funds prospectus that the sub-adviser had a well-established approach to responsible investing and that this includes "considering the Environmental, Social, and Governance (ESG) risks, opportunities, and issues throughout the research process via the sub-adviser's proprietary quality reviews, in an effort to ensure that any material ESG issues are considered." The SEC found that this statement, in the context of the portfolio managers' selection process, was misleading, because it failed to disclose that the sub-adviser neither required nor prepared quality reviews for all of the investments in the Overlay Funds.

In numerous RFP responses and in various board meetings, BNYMIA described the integration of ESG factors into the investment process and represented that "prior to making any investment" the sub-adviser "assigns to each company a proprietary ESG quality review rating designed to ensure that any material ESG issues of the company are taken into consideration." BNYMIA also stated, according to the order, in its RFP responses, that ESG considerations were taken into account for "each security being considered for investment." Again, the order noted these statements were misleading or incorrect when viewed in context of the selection process.

Further, prior to its March 2020 policy change, the sub-adviser's compliance department was not aware that quality reviews were not being performed for all Overlay Fund investments. Thus, according to the order, they

lacked the relevant facts when conducting reviews of BNYMIA's prospectuses and RFP responses. As a result, the SEC found that BNYMIA failed to adopt and implement policies and procedures reasonably designed to prevent the inclusion of untrue statements of fact in a prospectus or to fund boards.

The SEC considered BNYMIA's cooperation and proactive remedial efforts and imposed sanctions on BNYMIA of a $1,500,000 civil penalty, censure, and a cease-and-desist order, as agreed to by BNYMIA.

SEC Press Release – https://www.sec.gov/news/press-release/2022-86

Anti-Money Laundering Program Failures – Wells Fargo Advisors (May 20, 2022)

The SEC announced charges against broker-dealer and investment adviser Wells Fargo Clearing Services, LLC (d/b/a Wells Fargo Advisors) (***Wells Fargo***) for failing to file at least 34 Suspicious Activity Reports (***SARs***) in a timely manner between April 2017 and October 2021. Broker-dealers are required by the Bank Secrecy Act and regulations promulgated by the U.S. Treasury Department's Financial Crimes Enforcement Network to monitor customer brokerage account transactions for suspicious activity and file SARs for, among other things, transactions or patterns of transactions that the broker-dealer either knows or has reason to suspect involve fraud or have no apparent lawful business purpose. According to the order, Wells Fargo's failures were due to deficient implementation and insufficient testing of a new automated transaction monitoring system and failure to correctly process wire information into the system.

The recent charges are in part the result of what the SEC noted as Wells Fargo's deficient implementation and failure to test a new version of its internal anti-money laundering (***AML***) transaction monitoring and alert system adopted in January 2019. The system reportedly failed to reconcile the different country codes used to monitor foreign wire transfers. As a result, Wells Fargo did not investigate alerts and failed to timely file at least 25 SARs related to suspicious transactions involving wire transfers to or from foreign countries that it determined to be at a high or moderate risk for money laundering, terrorist financing, or other illegal money movements.

In parallel part, the SEC noted that Wells Fargo failed to file nine SARs because it did not process wire transfers appropriately into the transaction monitoring system in certain situations, such as on a bank holiday without a corresponding brokerage holiday. Wells Fargo discovered the problem several months later, corrected the data, and reviewed the alerts subsequently generated by the system; however, the window to file a timely SAR for the nine resulting reports had passed.

Unlike the 25 late SARs, which were discovered during a regulatory exam, Wells Fargo identified the wire transfer failures and notified the SEC shortly after discovering they impacted the transaction system. The SEC considered Wells Fargo's notification along with other remedial and cooperative measures in its acceptance of the settlement offer.

Wells Fargo agreed to pay a $7 million civil penalty to settle the charges. The $7 million settlement follows a $3.5 million penalty the broker-dealer was ordered to pay in 2017 for failing to timely file at least 50 SARs.

SEC Press Release – https://www.sec.gov/news/press-release/2022-85

Hedge Fund Fraud – EIA All Weather Alpha Fund I Partners, LLC and Andrew Middlebrooks (May 18, 2022)

The SEC filed an emergency order to halt ongoing fraud involving a hedge fund that raised $39 million by making numerous false and misleading statements to potential investors. The firm represented the fund as a "quantitative relative value fund" which purportedly made long/short equity investments in the global equity market. However, according to the SEC case, of the $39 million raised from over 100 investors, only $31 million was actually invested and $27 million of that was lost in trading activities. Middlebrooks allegedly misappropriated $1.7 million for personal use, and $9 million was reportedly paid out in Ponzi-like payments to redeem investor interest. The order alleges that at least $470,250 was transferred into accounts for Austin, Texas-based Shop Style Shark, LLC, managed by Middlebrooks' wife, Dionne Middlebrooks. The fund reported positive returns for five consecutive years, ranging from 54% to 135% when, according to the SEC order, the fund actually lost money every year during that period. Middlebrooks, on behalf of EIA All Weather, falsely represented in investor

materials and conversations that the fund had an auditor and would provide audited financial statements to investors. The fund never had an audit and the firm and its principal allegedly fabricated financial statements and an audit report to provide to current and prospective investors. The litigation is ongoing.

See Press Release – https://www.sec.gov/news/press-release/2022-90

Fraudulent Options Trading Scheme – Allianz Global Investors U.S. LLC (May 17, 2022)

The SEC charged Allianz Global Investors U.S. LLC (***AGI***), a New York based adviser that managed $148.8 billion in client assets, and three former senior portfolio managers with a multibillion-dollar fraudulent scheme. The SEC noted that AGI concealed the immense downside risks of a complex options trading strategy called "Structured Alpha" designed to generate profits by using a portfolio of debt or equity securities as collateral to purchase and sell options primarily on the S&P 500 Index. AGI marketed and sold at least 17 Structured Alpha funds to approximately 114 institutional investors, including public pension plans and other sophisticated investors, who invested approximately $11 billion in the strategy. In its complaint against the senior portfolio managers, filed in the northern district court in Manhattan, the SEC alleged numerous instances of intentional misconduct under the Advisers Act, from misrepresentations to investors to failures to follow the stated investment strategy, as well as multiple similar allegations under the various federal securities laws designed to prevent fraudulent, deceptive, and manipulative behavior. The SEC filed a corresponding civil case against AGI.

According to the cases, AGI and its senior portfolio managers willfully and materially misled investors about the significant downside risk over a 4-year period by manipulating financial reports and other information to conceal the magnitude of the risk and the funds' actual performance. For example, the portfolio managers modified information in risk reports sent to investors on multiple occasions, in one case reducing reported losses from negative 42.15% to 4.15%. Other times the managers "smoothed" performance data by reducing one day losses from negative 18.26% to 9.26%. Marketing materials explained how the portfolio and hedging positions were structured and noted that the primary objective of the hedging positions was to protect the strategy from a short-term equity market crash. However, instead of structuring the portfolio in the manner described, the portfolio manager purchased cheaper options with significantly lower strike prices. These options provided less protection to investors in the event of a short-term market drop. When the 2020 COVID-related market volatility revealed that AGI US had misled investors about the fund's level of risk, the fund suffered catastrophic losses and investors lost over $5 billion.

Among numerous other instances of wrongdoing, the portfolio managers engaged in multiple efforts to conceal their misconduct from the SEC. The multiple misrepresentations generally resulted in increased compensation to AGI and the portfolio managers. During the period in question, AGI received more than $550 million in fees for managing the Structured Alpha fund, which resulted in more than $500 million in net profits and significant compensation and bonuses paid to the portfolio managers.

In its settlement order, AGI admitted that its conduct violated federal securities laws and agreed to pay more than $1 billion in civil penalties ($350 million in disgorgement and interest and a $675 million penalty). AGI was automatically and immediately disqualified from providing advisory services to US registered investment funds for 10 years and agreed to exit the business over a 10-week period in a transaction to another adviser. Two of the three portfolio managers pled guilty to various charges of conspiracy, securities fraud, investment adviser fraud, wire fraud, and investment adviser fraud in parallel criminal proceedings and were generally barred from the industry by order of the SEC.

SEC Press Release – https://www.sec.gov/news/press-release/2022-84

Market Manipulation Scheme – Archegos Capital Management, LP (April 27, 2022)

The SEC charged family office Archegos Capital Management, LP (***Archegos***), its founder (and former manager to two unregistered hedge funds) and senior officers with a multibillion-dollar market manipulation scheme. The

family office was exempt from registration as an investment adviser under Rule 202(a)(11)(G)-1 of the Advisers Act.

Archegos' founder previously pled guilty to criminal insider trading charges and settled charges with the SEC for insider trading and attempted stock manipulation, which resulted in closure of the hedge funds and return of investor capital. The parties subsequently managed money through the family office structure.

Archegos pursued a long/short strategy with highly-levered and highly-concentrated long positions which were hedged through short exposure to exchange-traded funds and custom baskets and limited short exposure to single name issuers. Leverage ratios were typically 400-700% and sometimes as high as 1000%. The vast majority of Archegos's long exposure was synthetic, a deliberate strategy to limit the visibility of market participants and counterparties into the firm's aggregate holdings. According to the SEC's complaint, when the firm approached a 5% reporting threshold under Section 13 of the Exchange Act, it would generally shift from purchasing cash equity positions to purchasing synthetic exposure through security-based swaps. At the onset of the Covid-19 pandemic, the firm's capital was down fairly substantially. However, beginning after March 2020 through the first quarter of 2021, Archegos's portfolio underwent a rapid and exponential growth. As of March 31, 2020, the firm had approximately $1.6 billion in invested capital with gross exposures of approximately $10.2 billion. By January 1, 2021, those amounts had increased to $7.7 billion invested with $54 billion exposure and as of March 22, 2021, $36 billion invested with over $160 billion in gross exposure.

To facilitate such growth, the SEC alleges that Archegos engaged in a scheme to manipulate its largest holdings by dominating the market for those issuers, "setting the tone" (*i.e.*, engaging in large premarket trading), bidding up prices by entering incrementally higher limit orders throughout the trading day and "marking the close" (*i.e.*, engaging in large trading in the last 30 minutes of the trading day), and by other non-economic trading, all with the goal of artificially inflating the share prices of their large holdings. The complaint also alleges that Archegos provided false information to counterparties regarding its risk profile in order to obtain increased trading capacity to further its manipulative trading and increasing exposure.

Eventually, the weight of the firm's fraudulent and manipulative scheme was too much for Archegos to bear, and over the course of less than a week in late March 2021, the portfolio collapsed. Price declines in some of Archegos's largest holdings triggered significant margin calls that Archegos was unable to meet. In turn, without its trading activity to artificially inflate the prices of those holdings, the stock prices collapsed. Archegos's subsequent default resulted in billions of dollars in credit losses among its counterparties and significant losses to the market participants who invested in the stocks at inflated prices. The case is ongoing with a jury trial demanded, and the U.S. Attorney's Office for the Southern District of New York has announced parallel criminal charges.

SEC Press Release – https://www.sec.gov/news/press-release/2022-70

Jarkesy and SEC Enforcement Authority – Fifth Circuit Decision in Jarkesy v. SEC (May 18, 2022)

In May 2022, the Court of Appeals for the Fifth Circuit vacated an SEC decision that a hedge fund manager, George Jarkesy Jr. committed securities fraud, holding that the SEC may not bring enforcement actions before an in-house SEC ALJ because the statutory framework authorizing the SEC to do so is unconstitutional. The court held that (i) the SEC's use of an in-house adjudication proceeding for a securities fraud claim infringed the Judicial Branch's authority when it deprived Jarkesy of his Seventh Amendment right to a jury trial, (ii) statutory restrictions on removing ALJs unconstitutionally infringe on the President's exercise of executive authority, and (iii) the SEC's statutory discretion to bring an enforcement action in court versus in its own administrative tribunal infringe on the authority of the Legislative Branch.

By calling the constitutionality of the SEC's authority to bring and adjudicate cases into question, the ruling has the potential to restrain the SEC's authority if adopted in other jurisdictions, as well as constrain the SEC's desire or perceived ability to bring securities fraud cases before an administrative tribunal generally. However, the decision currently only applies to cases appealable within the Fifth Circuit. There is no indication the SEC has

slowed its enforcement efforts, though any indication in either direction is difficult to ascertain. First, the SEC has not commented publicly on the matter. Second, any quarter-over-quarter comparison of SEC enforcement statistics so far in 2022 is marred by prior quarters affected by the still-ongoing pandemic.

As noted in the introduction to this section, however, one key insight lies in a recent development. In July, the SEC petitioned the Fifth Circuit *en banc* asking for a rehearing of its *Jarkesy* decision with a full panel of judges (the decision was split 2-1). The Commission's petition argues that the Fifth Circuit should reconsider its decision because Jarkesy creates uncertainty and is in conflict with the Ninth Circuit's holding in *Decker Coal v. Pehringer* regarding the use of ALJs by the U.S. Department of Labor. The Ninth Circuit upheld the same removal restrictions that the Fifth Circuit found unconstitutional. The SEC also argues in its petition that the Fifth Circuit's first holding (as noted above) conflicts with Supreme Court and other circuit courts' precedent. At least one opposition to the SEC's petition has already been filed.

Though silent in public commentary, the SEC's 84-page petition demonstrates its readiness to address the question of its authority head-on.

Jarkesy v. SEC – *Jarkesy v. Securities & Exchange Commission*, 34 F. 4th 446 (5th Cir. 2022)

Other Regulatory Developments

Chief Compliance Officer Liability

Following a settled administrative proceeding against Hamilton Investment Counsel and its CCO, Commissioner Peirce issued a public statement on regarding CCO liability, a topic of great significance to compliance professionals. Peirce notes the vital role that CCOs play in ensuring that investment advisers and other industry participants comply with the federal securities laws. She further notes that although the SEC has not adopted a CCO liability framework, the New York City Bar Association (***NYC Bar***) recently proposed one for consideration. In her statement, Peirce poses the questions outlined in the NYC Bar Framework as an appropriate standard for analyzing whether it was appropriate in the Hamilton case for the SEC to bring charges against the CCO for conduct arising out of his compliance-related duties (***CCO Conduct Charges***). Following are the factors proposed for consideration under the NYC Bar Framework:

Affirmative Factors

General Factor

- Does the CCO Conduct Charge help fulfill the SEC's regulatory goals?

Wholesale Failure Factors

- Did the CCO not make a good faith effort to fulfill his or her responsibilities?
- Did the wholesale failure relate to a fundamental or central aspect of a well-run compliance program at the registrant?
- Did the wholesale failure persist over time and/or did the CCO have multiple opportunities to cure the lapse?
- Did the wholesale failure relate to a discrete, specified obligation under the securities laws or the compliance program at the registrant?
- Did the SEC issue rules or guidance on point to the substantive area of compliance to which the wholesale failure relates?
- Did an aggravating factor add to the seriousness of the CCO's conduct?

Active Participation in Fraud

- The SEC should demonstrate that the CCO's conduct "added value" in some way to the fraud committed by the firm or the other individuals charged.

Obstruction Factors

- Were the acts of obstruction or false statements repeated?
- Was the obstruction denied when confronted or did the CCO not immediately reverse course and cooperate?
- Did the obstruction relate to a necessary or highly relevant part of the examination or investigation?
- Did the evidence show other indicia of intent to deceive or disregard for cooperation with the SEC's regulatory mission?

Mitigating Factors

- Did structural or resource challenges hinder the CCO's performance?
- Did the CCO at issue voluntarily disclose and actively cooperate?
- Were policies and procedures proposed, enacted or implemented in good faith?

In her statement, Commissioner Peirce, a frequent opponent of recent SEC actions, concluded that the SEC did have a sufficient basis for bringing a CCO Conduct Charge in this instance. The case involved the adviser and CCO's failure to appropriately address conflicts of interest related to an investment adviser representative's (***IAR***) outside business activity (***OBA***) even after the CCO became aware of transfers of client assets to the IAR's other business.

In her support of the charges, Peirce noted that the case involved fundamental failures by the CCO under the firm's compliance program to appropriately monitor and address the IAR's OBA that gave rise to conflicts of interest and ultimately permitted investor harm. As a principal of the firm, Peirce noted that the CCO knew or should have known of the inadequacy of the firm's compliance program and that he had authority to address the compliance deficiencies but failed to do so for more than a year, despite the issue being brought to his attention repeatedly. She further noted that the legal principles in the case are well-established and therefore that the CCO's lapse could not be tied to the absence of SEC guidance.

Finally, Commissioner Peirce focused on the aggravating factor that the broker-dealer with which the IAR was associated specifically flagged certain transactions involving transfers of client assets to the outside business. Nevertheless, although the CCO had the opportunity to improve the compliance program, he failed to do so, thereby ultimately falling "materially short."

This case and the NYC Bar Framework are both instructive in helping CCO's understand when and how they may be deemed liable for compliance failures that occur on their watch and should provide a road map to help navigate the appropriate course of action when fulfilling compliance duties.

Anti-Money Laundering & Sanctions Developments

Following the Russian invasion of Ukraine, sanctions against Russia have continued to expand, with the U.S. Department of the Treasury's Office of Foreign Assets Control (***OFAC***), as well as sanctions authorities in the UK and EU, issuing dozens of new sanction regulations that impact countless segments of the global economy, including private funds. Unlike U.S. AML laws, which currently do not apply to private investment funds (however, see further information on this topic below), U.S. sanctions apply to all U.S. persons.

Sanctions apply with strict liability—which means it does not matter if you intended to violate the sanctions or if you made a mistake—a violation is still a violation. In practice, however, OFAC has shown that intent often does matter and will consider mitigating factors and whether violations are deemed to be "egregious" or "non-egregious" when considering potential penalties (which can be significant).

What to do if an investor is named to a sanctions list?

If an investor is named to a sanctions list, immediately cease any capital calls or distributions. Next steps will vary depending on the jurisdiction of the fund and the sanctions regime imposing the relevant sanctions. The U.S., UK, and EU sanctions regimes are distinct and need to be considered individually.

When an investor is sanctioned, even in one jurisdiction, it can impact the overall AML risk that the investor presents and may also impact the ability of the fund to make distributions or receive money from the investor. For example, the fund may be indirectly restricted by sanctions or regulations applicable to other financial institutions, in that those restrictions affect the ability of financial institutions or other service providers to process transactions with sanctioned parties.

Because firms are prohibited from further dealing with a sanctioned party, asset managers cannot give a sanctioned investor the proceeds from an asset sale or simply return their investment. In general, assets belonging to sanctioned parties need to be blocked or frozen. For Cayman-domiciled funds, Cayman counsel has generally been advising that assets belong to the fund until they are distributed. Assets associated with a sanctioned party are not therefore required under Cayman law to be segregated and can remain in the fund, though reporting to the applicable Cayman authorities is required. In the U.S., this is not the case. The U.S. prohibition on dealing with a sanctioned investor generally means a manager will need to remove the investor from its fund; however, a special license from OFAC may still be required to divest.

Firms should refer to a fund's governing documents alongside the relevant sanctions regime's requirements in each applicable jurisdiction and consider what action is appropriate on a case-by-case basis. If an investor is sanctioned elsewhere but not yet in the U.S., firms should consider the chances the investor will be added to U.S. lists later on and the increased risk that may pose to their funds. Standard due diligence on investors and investments likely needs to be increased.

Anti-Money Laundering Legislation

The U.S. House of Representatives recently passed a defense bill that includes a provision to require investment advisers to adopt anti-money-laundering policies.

The National Defense Authorization Act for Fiscal Year 2023, if signed into law, would amend the definition of "financial institutions" under the Bank Secrecy Act to include U.S.-based intermediaries, including investment advisers. Such a change would require that both registered and non-registered investment advisers comply with US AML requirements to:

- report suspicious transactions
- establish an anti-money laundering program
- establish due diligence policies and procedures; and
- identify and verify account holders.

Legislation subjecting investment advisers and other gatekeepers to AML requirements has been proposed multiple times over the past several years. The bill is now in the Senate. If passed as it currently stands, the same AML compliance obligations that apply to banks and brokers would be applicable to investment advisers, effective Dec. 31, 2023, with a full compliance date of June 30, 2024.

CORE will continue to monitor these developments and advise of any changes in status and the resulting implications to investment advisers.

Digital Asset Developments

$2 Trillion Crypto Market Crash

Over the past two months, more than $2 trillion dollars have gone to "money heaven" via the global cryptocurrency market, putting claims about crypto assets being an inflation hedge and a gold-like store of value in question. The most prevalent of all cryptos, Bitcoin, lost approximately $700 billion of its market cap since May

2022. Nonetheless, the total number of cryptocurrencies available topped 12,000 in June, which, compared to the 180 fiat currencies used around the world is a staggering figure.

SEC Cyber Enforcement Unit

Considering the significant volatility and virtually unlimited supply of these tokens, the SEC has continued its efforts to establish a regulatory framework surrounding cryptocurrency and digital assets and pursue several enforcement cases against crypto market participants. In addition, the SEC nearly doubled the size of the Crypto and Cyber Enforcement Unit which, since its creation in 2017, successfully brought more than 80 enforcement actions and recovered more than $2 billion in monetary relief. The expanded Crypto and Cyber Enforcement Unit aims to leverage the agency's expertise to ensure investors are protected in the crypto markets, with a focus on investigating securities law violations related to crypto asset offerings, exchanges and lending as well as decentralized finance platforms (DeFi), non-fungible tokens (NFTs), and stablecoins.

SEC Press Release – https://www.sec.gov/news/press-release/2022-78

Global Regulators' Pursuit of Cryptocurrency Regulation

Globally, considering the recent crypto-market meltdown, state regulators and governments are passing targeted legislation. For example, the Monetary Authority of Singapore (***MAS***) issued guidelines that cryptocurrency service providers should not promote their services to the general public in the city-state. In exercising its caution, the MAS has also denied applications to more than 100 cryptocurrency firms seeking to launch operations on its soil. Other countries such as Indonesia, China, and Thailand have opted for complete prohibitions on cryptocurrency trading.

In the U.S., the SEC has proposed "one rule book" for the regulation of crypto. SEC Chairman Gensler said that the SEC is working with crypto exchanges, lending platforms, brokers and other industry participants to ramp up investor protection in the space. The SEC boss revealed that he is working on a "memorandum of understanding" with his counterparts at the Commodity Futures Trading Commission, which would be a formal deal to ensure that trading in digital assets has adequate safeguards and transparency. Gensler said, "If this industry is going to take any path forward, it will build some better trust in these markets. I'm talking about one rule book on the exchange. Crypto may offer new ways for entrepreneurs to raise capital and for investors to trade, but we still need investor and market protection. We already have robust ways to protect investors trading on platforms. And we have robust ways to protect investors when entrepreneurs want to raise money from the public. We ought to apply these same protections in the crypto markets. Let's not risk undermining 90 years of securities laws and create some regulatory arbitrage or loopholes."

SEC Speech – https://www.sec.gov/news/speech/gensler-remarks-crypto-markets-040422

SEC Halts Cryptomining & Trading Scheme – MCC International Corp. *et. al*. (April 4, 2022)

In May 2022, the SEC announced fraud charges against MCC International Corp. d/b/a Mining Capital Coin Corp. (***MCC***) and its founders for fraudulent sales or unregistered offerings to thousands of investors. The complaint alleges that MCC engaged in sales of investment plans called mining packages, promising daily returns of 1%, paid weekly, for a period of up to 52 weeks. MCC also allegedly represented that the weekly profits were a result of "profit sharing" and that MCC earned profits from its operations involving cryptocurrency mining, trading stocks and foreign exchange, and trading cryptocurrency on digital asset trading platforms. MCC and its founders Capuci and Pires allegedly netted at least $8.1 million from the sale of the mining packages and $3.2 million in initiation fees. In addition, the complaint alleges that MCC investors were required to redeem their investments on Bitchain, a fake crypto asset trading platform Capuci created and managed. However, when investors tried to liquidate their investments on Bitchain before their 52-week memberships expired, they encountered purported errors that stymied their efforts and were required to either buy another mining package or forfeit their investments. "Capuci and Pires took every opportunity to extract more money from unsuspecting investors on false promises of outlandish returns and used investor funds raised from this fraudulent scheme to fund a lavish

lifestyle, including purchasing Lamborghinis, yachts, and real estate," said A. Kristina Littman, Chief of the SEC Enforcement Division's Crypto Assets and Cyber Unit.

The federal district court in the southern district of Florida issued a temporary order freezing Capuci and Pires' assets, among other relief. The case is ongoing.

SEC Press Release – https://www.sec.gov/news/press-release/2022-81