CORE REGULATORY FORUM

Q2 UPDATE

CORE-CCO | August 2023 | www.core-cco.com

Regulatory Deadlines

- Quarterly Form PF – Aug 29
- Form D – 15 Days after First Sale
- Schedule 13D/G – 10 Days after Triggering Transaction

Notable News Headlines

- "Private Equity, Hedge Funds Brace for Coming SEC Overhaul"

  WSJ
- "Tiger Global says ex-employee targets it in misinformation attacks"

  Reuters
- "Tesla investors to get $12,000 each from Musk's SEC deal"

  The Detroit News

Upcoming Events

- Real Estate Roundtable – Fall 2023
- Energy Roundtable – TBD

Contents

Introduction **2**

Recent SEC Rulemaking **2**

Form PF Amendments ____ 3

Security-Based Swap Anti-Fraud / CCO Undue Influence ____ 5

Exam Developments **5**

Risk Alert: Exams Focused on Adviser Marketing Rule ____ 5

Risk Alert: LIBOR-Transition Preparedness ____ 7

Risk Alert: Safeguarding Customer Records and Information ____ 7

Enforcement Developments **8**

Fees & Expenses ____ 9

Insider Trading ____ 10

Special Purpose Acquisition Companies (SPACs) ____ 11

Valuation ____ 12

Market Manipulation ____ 12

Cherry Picking ____ 13

Unregistered Broker-Dealer ____ 14

Cross Trades ____ 14

Electronic Communications ____ 15

FCPA Violations ____ 16

Miscellaneous Enforcement ____ 17

Other Regulatory Developments **18**

Anti-Money Laundering & Sanctions Developments ____ 18

Digital Asset Developments ____ 18

Privacy Law Developments ____ 22

Regulatory Updates and Enforcement

Introduction

More than a decade ago in June 2011, the Securities and Exchange Commission (***SEC***) adopted rules requiring the registration of hedge fund, private equity fund, and other private fund managers, many of which had previously be able to avoid registration because they had fewer than 15 fund clients. The registration requirements subjected private fund managers to the Investment Advisers Act of 1940, as amended (***Advisers Act***) and related requirements as well as the SEC's regulatory oversight and examination program. At the same time, the SEC adopted rules permitting certain smaller private fund managers and venture capital fund managers to remain exempt from full registration but requiring limited reporting from such firms on Form ADV. In the SEC Commission meeting at which such rules were adopted, then Chairwoman Mary Schapiro noted, "Today's rules will fill a key gap in the regulatory landscape. In particular, our proposal will give the Commission, and the public, insight into hedge fund and other private fund managers who previously conducted their work under the radar and outside the vision of regulators." Schapiro noted that the registration of advisers to hedge funds and private equity funds would "Provide the SEC and the public with information about the business operations of these advisers, as well as information about their conflicts of interest, disciplinary history and investment strategies." In the 10+ years since private funds were required to register in February 2012, the number of private funds as reported on Form ADV has grown from 31,717 with $9.8 trillion in assets to 100,947with $26.6 trillion in assets.

The SEC has since conducted thousands of examinations of many of those private fund managers and collected voluminous data in examinations and through quarterly and annual Form PF filings. The Exam Division launched a private fund unit (***PFU***) focused exclusively on monitoring and policing the private fund industry. SEC Enforcement staff have brought a series of enforcement actions over the last decade involving abusive practices, and in some cases simply naive practices, by private fund managers citing conflicts of interest, lack of transparency, and insufficient governance. Regulators and the financial industry have witnessed the expanding impact of private funds on the financial markets, with the amount of invested capital in private funds growing at a rate that outpaces the public markets. Current SEC Commissioner Caroline Crenshaw noted in recent public statement that "between 2000 and 2021, private equity global assets under management grew at four to five times faster than the overall U.S. economy." Therefore, it should not be a surprise that the SEC has used the data and information gathered through its regulation of private fund managers to formulate new and expanded private fund rules intended to address and mitigate the concerns noted by its staff as key pitfalls in an otherwise burgeoning industry. After 18 months of deliberation, the recently-finalized pivotal private fund rulemaking, as summarized in detail in our separate client alert, represents another important chapter in private fund regulatory history. CORE was birthed out of the 2011 private fund rulemaking and has spent the past 12 years working collaboratively with private fund clients to effectively navigate the changing regulatory and compliance landscape. We will continue to partner with clients to help them understand the impact of the current rulemaking on their business and ensure that they build and administer compliance programs that are designed to withstand regulatory scrutiny, protect the firm and its team, as well as its clients and investors from regulatory, compliance, operational and related risk factors.

Recent SEC Rulemaking

Several new rules were finalized in Q2 or shortly thereafter that do not directly impact our private fund clients but may have some indirect implications. In addition, one new rule focused on artificial intelligence (***AI***) was proposed after the close of the quarter that will impact private fund advisers. Finally, several pending rules were reopened for public comment. Following are SEC rulemaking highlights from Q2 and more recent actions.

- **Private Fund Rules** – In August 2023, the SEC adopted final private fund rules, which will 1) require standardized quarterly reporting of fees, expenses and performance, 2) require audits of all private funds, 3) impose restrictions and disclosure requirements on certain expense allocations, clawback reductions for tax liabilities, and borrowing from funds, 4) limit and require disclosure of preferential treatment through side letters and other agreements, and 5) require independent opinions on adviser-led secondaries. *See* https://www.sec.gov/news/press-release/2023-155.

Regulatory Updates and Enforcement

- **Safeguarding Rule** – In August 2023, the SEC re-opened the comment period for the recently proposed Safeguarding Rule (as summarized in the *Q1 2023 Update*). In light of the adoption of the private fund adviser audit rule, which generally requires a registered investment adviser to obtain an annual financial statement audit of each private fund it advises in accordance with the audit provision of the current custody rule, the SEC noted that reopening the comment period would allow interested persons additional time to assess the proposed amendments to the current custody rule's audit provision in light of the private fund adviser audit rule. *See https://www.sec.gov/news/press-release/2023-156.*
- **Share Repurchase Disclosure** – In May 2023, the SEC adopted amendment to modernize and improve disclosures by issuers about repurchases of their equity securities. The amendments will require issuers to disclose additional detail regarding their daily repurchase activity, the company's repurchase program in general, as well as disclosure regarding director and officer trading in relevant securities, and the issuer's adoption and termination of 10b5-1 trading arrangements. This disclosure may be relevant to hedge fund managers and others who monitor and analyze issuer activities. *See https://www.sec.gov/news/press-release/2023-85.*
- **Public Company Cybersecurity Risk Management** – In July 2023, the SEC finalized a cybersecurity risk management rule for public companies. While the rule will not directly impact private fund managers, it included similar provisions as what has been proposed and is still pending for registered investment advisers (***RIAs***). The final rule requires companies to report material cybersecurity incidents within four business days of determining that the incident is material. The proposed RIA rule would require reporting significant cybersecurity incidents within 48 hours of determining that an incident has occurred. We are hopeful that the final RIA rule with include a more reasonable timeline consistent with the public company disclosure. *See https://www.sec.gov/news/press-release/2023-139*.
- **Predictive Data Analytics** – In July 2023, the SEC proposed a rule that would require RIAs and broker dealers to eliminate or neutralize conflicts of interest associated with, and develop written policies and procedures to address, their use of predictive data analytics or artificial intelligence (***AI***). The definition of covered data in the proposed rule is very broad and will hopefully be refined in the final rulemaking to more narrowly cover actual AI and not more common analysis widely used by RIAs. We will summarize the proposed rule in greater detail in the Q3 Quarterly Update. *See https://www.sec.gov/news/press-release/2023-140*.
- **Modernization of Beneficial Ownership Reporting** – In April 2023, the SEC published additional data and analysis on expected economic effects of its 2022 proposal (as summarized in the *Q1 2022 Update*) to modernize the filing deadlines for initial and amended beneficial ownership reports on Schedules 13D and 13G and provide clarification regarding requirements for two or more persons acting as a group. The SEC re-opened the comment period through June 27, 2023. *See https://www.sec.gov/news/press-release/2023-83.*
- **Position Reporting of Large Security-Based Swap Positions** – In June 2023, the SEC provided supplemental data and analysis regarding reporting thresholds with respect to is proposal to require any person/entity holding a large security-based swap position to promptly report to the SEC, as proposed in December 2021. At the same time, the SEC reopened the comment period for this rulemaking through August 21, 2023. *See https://www.sec.gov/news/press-release/2023-113.*

Form PF Amendments

The SEC made two proposals in 2022 for changes to Form PF, the reporting form for private funds designed to provide the SEC and Financial Stability Oversight Counsel (***FSOC***) with important, confidential information about the operations and strategies of private funds and enhance their ability to monitor systemic risk, bolster regulatory oversight of private funds and enhance investor protection. The first of the proposals, issued in January 2022, was largely finalized in May 2023 and will impact all private equity (***PE***) and large hedge fund (***HF***) managers in the near term. Rules requiring immediate reporting (as detailed below) for large HF managers and quarterly

reporting for all PE fund managers in newly added Sections 5 and 6 of the Form PF will be effective December 11, 2023. The effective/compliance date for amendments to existing sections of the form (Sections 1-4) is June 11, 2024, which means that it will not impact annual Form PF filings that are due in April 2024. The SEC decided not to decrease the threshold for a large PE fund from $2 billion to $1.5 billion in RAUM as originally proposed. A summary of the final requirements is below.

Immediate Reporting for Large HF Managers – Large hedge funds will be required to report "as soon as practicable" (but within 72 hours) on a new Section 5 of Form PF with respect to certain events that may present risks or material implications to fund investors or indicate systemic risks, including the following:

- Extraordinary investment losses
- Significant margin and counterparty defaults
- Material changes in prime broker relationships
- Key operations events
- Significant withdrawals or redemptions
- Inability to satisfy redemptions or suspension of redemptions

Quarterly Reporting for All PE Managers – All private equity fund managers will be required to report material events, within 60 days of the fiscal quarter-end in which the following events occur, on new Section 6. Such events include the following:

- Execution of adviser-led secondary transactions
- Removal of a fund's general partner
- Early termination of a fund's investment period
- Early termination of a fund

An adviser-led secondary transaction would include any transaction initiated by the adviser or its related persons that offer private fund investors the choice to: 1) sell all or a portion of their interests in the private fund; or 2) convert or exchange all or a portion of their interests in the private fund for interests in another vehicle advised by the fund's adviser or a related person.

Large PE Fund Reporting – Large PE funds are still only required to file the full Form PF annually within 120 days of fiscal year end but must submit Section 4 with extensive information about controlled portfolio companies and other fund data. Under the amended rule, large PE Fund annual reporting will include additional information regarding:

- Fund investment strategies
- Fund level borrowings
- Events of default
- Bridge financing to controlled portfolio companies
- Geographic breakdown of investments

Large PE Fund managers must also report in Section 4 as part of their annual filing the implementation of 1) any general partner clawback or 2) limited partner clawbacks in excess of an aggregate amount equal to 10% of a fund's aggregate capital commitments. This reporting will include the effective date of the clawback and reason for the clawback.

In July 2023, the SEC adopted additional amendments to Form PF to require additional information regarding liquidity funds that is generally aligned with concurrent money market fund reforms. The money market reforms otherwise apply to registered investment companies. The amendments jointly proposed with the Commodity Futures Trading Commission (***CFTC***) in August 2022, primarily related to large hedge fund managers and qualifying hedge funds, are still in the proposal phase and have not yet been adopted.

SEC Press Releases – https://www.sec.gov/news/press-release/2023-86 and https://www.sec.gov/news/press-release/2023-129

Regulatory Updates and Enforcement

Security-Based Swap Anti-Fraud / CCO Undue Influence

The SEC adopted rules on June 7, 2023, which were effective in early August, to prevent fraud, manipulation, and deception in connection with security-based swap transactions and to prevent undue influence over the chief compliance officer (***CCO***) of security-based swap dealers and major security-based swap participants (***SBS Entities***). New Rule 9j-1 of the Securities Exchange Act of 1934 (***Exchange Act***) prohibits any person directly or indirectly to effect or attempt to effect any transaction, purchase or sale of security-based swaps in connection with various forms of misconduct, generally involving making untrue statements or omissions of material fact. The rule also prohibits manipulation of the price or valuation of any security-based swap. Hedge funds and other private funds that participate in security-based swap transactions would be subject to such prohibitions. Rule 15fh-4(c) of the Exchange Act prohibits undue influence of the CCO of SBS Entities, which CORE's clients generally are not. However, the rule was designed to protect the independence and objectivity of SBS Entities' CCOs and does illuminate the SEC's view of the significance of CCO objectivity and independence and may, therefore, provide guidance to CCOs as well as senior management and other supervised persons of RIAs with respect to behavior that the SEC will not tolerate. Specifically, the rule prohibits any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder. The SEC declined requests by commenters to provide more clarity with regard to the intent and conduct required to be liable under the rule. However, the final release confirmed that the rule does not cover good faith disagreements or legitimate discussions with the CCO regarding business practices or compliance. Moreover, the SEC release stressed that attempts by officers, directors, or employees to hide transactions, submit false valuations, or manipulate or fraudulently influence the CCO in the performance of their duties related to risk mitigation would undermine the SBS Entity's risk management and could pose risk to the market. Therefore, the SEC adopted the rule that it intended to be broad enough to apply to these actions and any others that may undermine the independence and responsibilities of the CCO.

SEC Press Release – https://www.sec.gov/news/press-release/2023-104

Exam Developments

The Division of Examinations (***Exam Division***) has undertaken various initiatives with an active Marketing Rule compliance exam sweep based on responses to the "marketing activities" section of Form ADV. While the documents requested as part of such sweep extend beyond marketing materials and activities, the staff seems focused specifically on the use of hypothetical performance, as well as advertisements in general and the adequacy of policies, procedures, and training to comply with the new rule. We expect to see a series of enforcement cases coming out of this initiative going forward and potentially additional risk alerts regarding observations, concerns and best practices. The Fort Worth Regional Office (***FWRO***) of the SEC held an outreach program in May with participation by local compliance roundtables in Dallas, Houston, Austin/San Antonio. The Exam Division has learned since the Covid pandemic that their mission can be accomplished in a virtual environment. Examiners have conducted a mix of remote and in-person exams since the pandemic. While they do not expect in-person exams to increase to pre-pandemic levels, examiners do now conduct onsite exams when needed. Going forward, examiners plan to provide closing letters, which should help give firms clarity on when the exam process is complete. Among other highlights, the FWRO noted exam staff focus on electronic communications, the use of artificial intelligence/AI, cryptocurrencies and digital assets, as well as other FY 2023 exam priorities as highlighted in the Q1 2023 Regulatory Update. Following are summaries of a couple risk alerts issues during Q2 2023.

Risk Alert: Examinations Focused on the Adviser Marketing Rule

The Exam Division issued two recent Risk Alerts to inform advisers of their examination activities and review areas to evaluate compliance with the amended Marketing Rule. The first was issued in September 2022

announcing an expected examination sweep and summarized in the Q3 2022 Regulatory Update. The second was issued in June 2023 to highlight additional areas of emphasis during such examinations. The areas highlighted included:

- *Policies and Procedures* – Whether advisers have adopted and implemented written policies and procedures that are reasonably designed to prevent violations by the advisers and their supervised persons of the Advisers Act and the rules thereunder, including the Marketing Rule.
- *Substantiation Requirement* – Whether advisers can substantiate material statements of fact. If an adviser cannot substantiate a material claim, the SEC will presume the adviser did not have a reasonable basis for its belief.
- *General Prohibitions* – Whether advisers have disseminated advertisements that violate any of the following general provisions under the rule:
    - Include untrue statements of material facts or omit material facts necessary to ensure statements made are not misleading;
    - Include material statements of fact for which the adviser does not have a reasonable basis or cannot substantiate;
    - Include information that would be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact;
    - Discuss any potential benefits without providing fair and balanced treatment of associated material risks and limitations;
    - Refer to specific investments in a manner that is not fair and balanced;
    - Include or exclude performance results or time periods that is not fair and balanced; or
    - Include information that is otherwise materially misleading
- *Performance Advertising Requirements* – Whether advisers are complying with the specific performance advertising requirements established in the Marketing Rule.
- *Books and Records* – Whether advisers are complying with Rule 204-2 that requires firms to maintain records of all advertisements they disseminate, including certain internal working papers, performance related information, and documentation for oral advertisements, testimonials, and endorsements.
- *Testimonials & Endorsements* – Whether advisers are complying with the following provisions:
    - *Disclosure* – Clear and prominent disclosure regarding relationship with persons giving testimonials or endorsements, compensation and other material conflicts of interest.
    - *Oversight* – Reasonable basis for believing testimonials or endorsements disseminated comply with the Marketing Rule.
    - *Written Agreements* – Required written agreements except where promoters receive de minimis ($1000 or less) in cash/non-cash compensation.
    - *Bad Actors* – Whether adviser know or should have known that a promoter was ineligible based on prior bad acts.
- *Third-Party Ratings* – Whether advisers are complying with the following provisions:
    - Disclosure – Clear and prominent disclosure of: 1) the date of rating and period on which it was based; 2) identify of party that created rating; and 3) any direct or indirect compensation.
    - Questionnaire / Survey – Reasonable belief that questionnaire or survey used to prepare rating is objective, includes favorable and unfavorable responses, and not designed to produce any predetermined results.
- *Form ADV* – Whether advisers accurately completed marketing activities questions.

The alerts encouraged advisers to reflect on their practices, written policies and procedures, and implement any training, supervisory, and oversight modifications as necessary.

SEC Risk Alert – https://www.sec.gov/files/risk-alert-marketing-rule-announcement-phase-3-060823.pdf

Risk Alert: LIBOR-Transition Preparedness

The Exam Division conducted exams leading up to June 30, 2023, the date at which the U.S. Dollar LIBOR would be discontinued. The exams focused on a limited group of private funds that invest in private credit, such as collateralized loan obligations, but more on 1) advisers associated with large bank complexes; 2) advisers to mutual funds, closed-end funds, exchanged-traded funds, and business development companies; 3) small, medium and large fund complexes; and 4) large retail-oriented advisers. As expected, firm preparation efforts varied considerably, depending on the type and amount of LIBOR exposure. The staff noted the following effective practices firms had implemented in preparation for the transition. While many private funds and CORE clients were not materially impacted by the LIBOR transition, these practices are nevertheless instructive as they relate to preparation for any material business or regulatory development.

- *Risk Management* – Establishment of internal cross-functional working groups and enterprise risk governance; membership or reliance on guidance from the Alternative Reference Rates Committee ("***ARRC***"); and proactive internal training and guidance.
- *Operations* – Active engagement with service providers, sub-advisers, and third-party managers; extensive system testing to confirm systems can accommodate alternate processes; and reconciliation processes to ensure terms and conditions were properly accounted for.
- *Portfolio Management* – Identification of exposure with respect to investment activities; substantive review of fallback provisions; trade restrictions, testing and other needed internal controls; early transition with respect to certain investments and activities, where feasible.
- *Fiduciary Responsibilities & Investor Communications* – Review of contracts and service provider readiness; assessment, disclosure and mitigation of risks and conflicts of interest; risk disclosures and information sharing with clients.
- *Ongoing and New Challenges* – Staying abreast of ongoing and new challenges to smooth transition and proactive work to anticipate and prepare accordingly.

SEC Risk Alert – https://www.sec.gov/files/risk-alert-libor-transition-preparedness-051123.pdf

Risk Alert: Safeguarding Customer Records and Information

Regulation S-P (***Reg S-P***) requires investment advisers and broker-dealers to adopt written policies and procedures to address administrative, technical, and physical safeguards to protect customer records and information. These procedures must be reasonably designed to ensure security and confidentiality of customer information, protect against anticipated threads or hazards to the integrity of such records and information, and protect against unauthorized access to or use of information. In April 2023, the Exam Division issued a Risk Alert highlighting the importance of establishing written policies and procedures for safeguarding customer records and information particularly at branch offices. Examiners noted that firms often implement fulsome procedures to safeguard records at their main office but fail to do so at smaller branch offices. The same concerns are likely true with respect to safeguarding records with employees working remotely or from home offices. The risk alert noted the following common concerns related to branch offices:

- *Vendor Management* – Inadequate due diligence and oversight of vendors or service providers of cybersecurity, technology operations and business applications, resulting in weak or misconfigured security settings on systems or apps that could result in unauthorized access.

- *Email Configuration* – Allowing employees to obtain their own email services not managed by the main IT staff or IT provider without specifying technical requirements or ensuring safe configurations.
- *Data Classification* – Failure to apply data classification policies and procedures to identify where customer records and information should be stored.
- *Access Management* – Failure to require complex passwords and multi-factor authentication for remote access to firm system and other controls, resulting in data breaches that could have been avoided.
- *Technology Risk* – Failure to implement procedures for inventory management, patch management, and vulnerability management in branch offices, resulting in unpatched, outdated systems that were no longer supported and prone to compromise.

SEC Risk Alert – https://www.sec.gov/files/risk-alert-safeguarding-info-branch-offices-042623.pdf

Enforcement Developments

The pace of and nature of SEC enforcement actions continued throughout the 2nd quarter. In May 2023, the SEC announced the largest-ever award of nearly $279 million made to a whistleblower whose assistance proved critical in the success of an SEC enforcement case. Although the unnamed whistleblower in the case did not initially deliver the information that opened the SEC's investigation, his/her multiple interviews and written submissions significantly expanded the scope of the investigation and helped ensure the success of the enforcement action. The SEC reiterated the value of the Whistleblower Program in holding bad actors accountable and reminded the investment community to come forward with information about potential securities law violations. No money was taken or withheld from harmed investors to pay the whistleblower award. Whistleblower awards can range from 10 to 30 percent of the money collected when an enforcement case is successful and the monetary sanctions exceed $1 million. As set forth in the Dodd-Frank Act, the SEC protects the confidentiality of whistleblowers and does not disclose any information that could reveal whistleblower identities.

Various events unfolded outside of the SEC's walls that nevertheless will impact future SEC enforcement actions. On June 30, 2023, the U.S. Supreme Court granted the SEC's petition for a writ of certiorari, agreeing to hear arguments in SEC v. Jarkesy, a case involving constitutional challenges by a hedge fund manager charged with fraud in an administrative proceeding. In May 2022, the Fifth Circuit agreed with Jarkesy and held that the SEC violated the Constitution by filing an enforcement action seeking monetary penalties for fraud before an administrative law judge (***ALJ***), rather than in federal court before a jury. Specifically, the court held that Jarkesy and the other defendants were deprived of their right to a jury trial; that Congress impermissibly delegated legislative powers by granting the SEC unfettered discretion in choosing whether to bring matters before ALJs; and that restrictions on the removal of SEC ALJs constricted the president's constitutionally mandated oversight over inferior government officers. Time will tell what the Supreme Court will hold in the case and the future of ALJs in SEC proceedings.

In July 2023, the U.S. District Court for the District of Columbia issued a decision in the closely watched dispute between the SEC and law firm Covington & Burling (Covington) concerning the SEC's subpoena for a list of Covington public company clients impacted by a cyberattack that potentially misappropriated material non-public information (***MNPI***). Covington refused, arguing, among other things, that revealing client names under these circumstances would not only violate the attorney-client privilege, but would also breach the firm's duty of confidentiality owed to its clients and violate clients' privacy rights. However, after reviewing briefs submitted by both sides, including dozens from the defense bar, and hearing oral argument, the court ultimately held that Covington must disclose the names of the seven clients as to whom Covington has not been able to rule out that the threat actor accessed MNPI.

Following are summaries of recent SEC enforcement cases involving or instructive for private fund managers.

Regulatory Updates and Enforcement

Fees & Expenses

PE Fund Charged with Overcharging Fees & Failing to Disclose Fee Conflict (June 20, 2023)

The SEC brought an action against Insight Venture Management LLC for charging excess management fees and failing to disclose a conflict of interest to investors related to fee calculations. Fund limited partnership agreements (***LPAs***) established that post-commitment period management fees would be calculated based on invested capital, which equaled the acquisition cost of the funds' portfolio investments. The LPA further provided that if a portfolio investment suffered a "permanent impairment," as defined in the LPA, the firm would reduce the calculation by the difference between acquisition cost and the impaired value. The firm had the ability to reverse the permanent impairment determination if the portfolio investment value subsequently increased. The LPA specifically defined and distinguished between a "portfolio company," an entity in which a portfolio investment is made, and a "portfolio investment," any debt or equity investment. Accordingly, there could be multiple portfolio investments in a particular portfolio company. The firm used a four-pronged test to determine whether a portfolio investment was impaired. However, the SEC noted that the firm assessed permanent impairment at the aggregated portfolio company level as opposed to the portfolio investment level, which resulted in the firm charging excess management fees of nearly $773,754 over a four-year period. Insight further failed to disclose to investors its conflict of interest with respect to its permanent impairment criteria. Investors were consequently unaware that the criteria Insight used were narrow and subjective, making them difficult to satisfy. Investors were similarly unaware that the criteria granted significant latitude to determine whether an asset would be considered permanently impaired and thus reduce the basis used to calculate fees. The SEC charged the firm with violating Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. To settle the case, Insight agreed to pay a $1.5 million penalty and $864,958 in disgorgement and prejudgment interest.

SEC Press Release – https://www.sec.gov/news/press-release/2023-112

Advisory Fees, Fee Waivers & Other Disclosures (June 16, 2023)

Registered investment adviser, Pacific Investment Management Company LLC (***PIMCO***), was cited by the SEC in two actions for failure to disclose material information to investors. In the first action, PIMCO failed to disclose sufficient information to investors concerning one of its funds' paired interest rate swap strategy and the impact the swaps had on fund dividends. Specifically, the payments earned on one leg of the pair were offset to some extent by a capital loss when the other leg of the pair was closed out. The fund paid quarterly dividends a significant portion of which was derived from the income generated in the paired strategy. The SEC noted that portions of the dividend distributions were reported and taxable as ordinary income but were economically equivalent to a return of capital. PIMCO subsequently reduced its dividend rate and enhanced disclosure regarding the impact of the paired strategy. However, the SEC charged PIMCO under Section 206(4) of the Advisers Act and Section 34(b) of the Investment Company Act of 1940 (***Company Act***) with inadequate disclosure. The firm agreed to a $6.5 million penalty with respect to this action.

In a second action, the SEC found that for six years PIMCO failed to accurately waive advisory fees as required by its agreement with one of its fund-of-funds that invested in other PIMCO funds. PIMCO essentially earned fees from both the fund-of-funds and the underlying funds. Accordingly, the fund's governing documents established a fee waiver to limit the total fees earned under the structure. The fee waiver was initially calculated internally and subsequently delegated to the fund administrator to calculate based on a calculation spreadsheet and instructions provided by PIMCO. However, it was later determined that the calculation methodology did not adequately take into account the use of leverage, resulting in a lower waiver than should have been applied. The fund administrator ultimately identified the error and PIMCO voluntarily, and prior to the SEC investigation, paid back to investors the $27 million in fees that should have been waived, plus a $3.2 million performance adjustment that the fund would have earned on the $27 million plus interest. The firm notified the fund Board and shareholders. Notwithstanding the firm's self-identification and actions taken to correct the error, the SEC brought the enforcement action under Rule 206(4)-7citing PIMCO with failure to establish adequate written policies and procedures with respect to its oversight of advisory fee calculations and fee waivers. PIMCO agreed to pay a $2.5 million penalty with respect to this action.

SEC Press Release – https://www.sec.gov/news/press-release/2023-109

Regulatory Updates and Enforcement

Insider Trading

Registered Rep & CCO Charged with Insider Trading (June 29, 2023)

The SEC charged two individuals, Jordan Meadow, a registered representative for a New-York based broker-dealer and Steven Teixeira, the Chief Compliance Officer of an international payment processing company, with insider trading based on material non-public information. Teixeira allegedly accessed nonpublic information on upcoming mergers and acquisitions of public companies from his girlfriend's computer, when she was working from home during the COVID-19 pandemic, and used the information to purchase call options on issuers ahead of the deal announcement. Teixeira then tipped the information to friends, including Meadow. Teixeira's girlfriend was an executive assistant at a prominent New York-based investment bank, with access to non-public information regarding potential mergers and acquisitions of publicly traded companies. Teixeira personally profited $28,600 by ill-using the information. Meadow made more than $730,000 from his unlawful trading. Additionally, Meadow recommended trades to his brokerage customers based on the non-public information. His trades gained millions of dollars in profits for customers and hundreds of thousands of dollars in commissions for himself. Both defendants were charged with violating the anti-fraud provisions of the federal securities laws. The SEC's investigation is ongoing, and the SEC is seeking disgorgement with prejudgment interest, civil penalties, and bars for both men based on their positions as officers or directors of public companies. Additionally, the U.S. Attorney's office filed criminal charges against both men.

SEC Press Release – https://www.sec.gov/news/press-release/2023-124

Pfizer Statistician Insider Trading Ahead of COVID-19 Announcement (June 29, 2023)

Amit Dagar, a former Pfizer Inc. employee and his friend and business partner, Atul Bhiwapurkar, were charged by the SEC with insider trading. The SEC alleged that the men traded in advance of the company's public announcement sharing the success of its COVID-19 antiviral treatment study. Dagar, a senior statistical program leader for the Paxlovid trial, learned of the testing results a day before the public announcement. His supervisor sent Dagar a chat sharing the positive trial outcome and identifying the public announcement timeline to be the following day. In advance of the announcement, Dagar purchased short term, out-of-the-money Pfizer call options, including options that expired the next day. He then tipped Bhiwapurkar who similarly purchased call options. Dagar and Bhiwapurkar gained $214,395 and $60,300 respectively in illicit profits. Their returns amounted to one-day investment gains of 2,458 percent and 791 percent respectively. The SEC's Market Abuse Unit's Analysis and Detection Center used trade surveillance and data analysis to detect the suspicious trading patterns. The SEC charged both men with violating the antifraud provisions of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 thereunder. Litigation is pending and the SEC is seeking disgorgement with prejudgment interest, and civil penalties. The U.S. Attorney's Office announced parallel criminal charges in conjunction with the case.

SEC Press Release – https://www.sec.gov/news/press-release/2023-123

Police Chief & Others Charged with Insider Trading Ahead of Merger (June 29, 2023)

The police chief of Dighon, Massachusetts along with four friends were charged by the SEC with insider trading associated with trading before the announcement of a tender offer by Alexion Pharmaceuticals Inc. to acquire Portola Pharmaceuticals Inc. The four defendants allegedly traded on nonpublic information obtained from a fifth defendant, Joseph Dupont. Dupont was a vice president and part of the acquisitions team at Alexion. He tipped information about the acquisition to his friend Shawn Cronin, the police chief. Cronin then passed the information on to friends Jarrett Mendoza and Stanley Kaplan, who provided advice to Cronin on trading strategies. Kaplan then shared the information with a colleague, Paul Feldman. The SEC complaint alleged that Cronin, Mendoza, Kaplan, and Feldman all exploited the information to purchase Portola stock and/or out-of-the money call options prior to the announcement. Kaplan and Feldman additionally passed the information on to others who traded profitably. Portola's stock price increased more than 130 percent on the day of the acquisition announcement. Perpetrator's ill-gotten profits were as follows: Cronin - $72,000; Mendoza - $39,000; Kaplan - $472,000; and

Feldman - $1.73 million. Other uncharged traders who received the information from Kaplan or Feldman also realized profits of an additional $1.7 million. After instigating the scheme, Kaplan texted Feldman in Russian saying, “Let’s hope our goose will continue laying golden eggs.” The SEC charged all five men with violating the antifraud and tender offer provisions of the federal securities laws and is seeking permanent injunctive relief, disgorgement, prejudgment interest, and civil penalties. Additionally, the SEC is seeking officer and director bars against each defendant. Litigation is pending.

SEC Press Release – https://www.sec.gov/news/press-release/2023-122

Special Purpose Acquisition Companies (SPACs)

SPAC Insider Trading (June 29, 2023)

A June SEC complaint accused three defendants of monetizing MNPI to gain illegal profits. Bruce Garelick, a former board member of SPAC, Digital World Acquisition Corporation (DWAC), Michael Shvartsman and his firm Rocket One Capital LLC, and Gerald Shvartsman were all cited for trading in advance of DWAC’s announcement that it had reached an agreement to acquire Trump Media & Technology Group Corp. As a DWAC board member, Garelick had access to confidential information about the acquisition negotiations and even voted on the nonpublic action. Garelick, who also served as the chief strategy officer at Rocket One Capital, shared this protected information with his boss, Michael Shvartsman who then communicated it to his brother, Gerald Shvartsman. Each of the three defendants purchased DWAC securities on the open market based on the unlawfully communicated information. Michael Shvartsman placed his trades through an account in the name of Rocket One Capital. The Shvartsman brothers sold their positions shortly after DWAC announced the merger agreement and realized illicit profits of more than $22.9 million from the trades. In addition, Garelick failed to file SEC Forms 4 and 5 related to his transactions in DWAC securities although he had reporting obligations based on this role as a DWAC director. The three defendants were charged with violating the antifraud provisions of the federal securities laws while Garelick was also charged with violating reporting obligations under Section 16 of the Exchange Act. The SEC is seeking permanent injunctive relief, disgorgement, prejudgment interest, and civil penalties against all three men, as well as officer and director bars against Garelick and Michael Shvertsman. Criminal charges against the defendants have been filed by the U.S. Attorney’s Office and litigation is pending.

SEC Press Release – https://www.sec.gov/news/press-release/2023-121

SPAC Audit Firm Charged with Quality Control Deficiencies (June 21, 2023)

The SEC filed charges against audit firm Marcum LLP for inadequately serving its gatekeeping function in protecting capital markets. The SEC identified quality control failures and violations of audit standards in connection with Marcum’s audit work for hundreds of SPAC clients. According to the Commission’s complaint, Marcum tripled its number of public company clients within a three-year period adding 600 new SPAC clients. The uncontrolled rate of growth resulted in substantial and widespread deficiencies in the firm’s quality control policies, procedures, and monitoring. Marcum failed to comply with audit standards related to documentation, quality reviews, risk assessments, audit committee communications, engagement partner supervision/review, and due professional care. Violations were identified in 25-50 percent of the Marcum audits reviewed. According to the SEC complaint, nearly all Marcum SPAC audits displayed violations of audit standards, putting its clients and the investing public at risk. The SEC alleged that Marcum prioritized its increased revenue over its audit quality. The SEC charged Marcum with engaging in improper professional conduct as designated by Rule 102(e) of the SEC’s Rules of Practice, violating multiple audit standards across many engagements, and violating Rule 2-02(b)(1) of Regulation S-X. The SEC mandated that Marcum retain an independent compliance consultant to assess and strengthen its audit, review and quality control policies and procedures. To settle the case, Marcum agreed to pay a $10 million penalty, to be censured, to undertake remedial actions, and to abide by restrictions on the type and number of new audits clients the firm would accept.

SEC Press Release – https://www.sec.gov/news/press-release/2023-114

Adviser Charged with Failing to Disclose SPAC Conflict (May 30, 2023)

The SEC brought a settled action against a New York investment adviser, RTW Investments, LP (***RTW***) for failing to disclose conflicts of interest regarding its personnel's ownership of sponsors of SPACs in which the firm advised private fund clients to invest. The firm formed two SPACs whose sponsors were owned both by firm personnel and private funds the firm managed. Firm personnel were entitled to a portion of the compensation the SPAC sponsors received upon completion of the SPACs' business combinations and had financial incentives to recommend that the SPACs engage in business combination transactions, even if the transactions or their terms were not in the best interests of the funds. The SEC noted that in connection with one SPAC's business combination, RTW caused the funds to forfeit, and the SPAC to cancel, all of the private placement warrants the funds had purchased in order to facilitate the consummation of the business combination. In connection with the second SPAC's business combination, RTW caused the funds to forfeit, and the SPAC to cancel, a portion of the private placement warrants in order to facilitate the consummation of the business combination. The order noted that RTW further directed the funds to make a $25 million bridge financing investment in the target company for one SPAC, which satisfied the SPAC's prior commitment to provide $20 million in financing for any business combination. The firm also caused the funds to purchase $9.2 million of the SPAC common stock in the open market before shareholders voted to approve the business combination. The firm similarly caused the funds to engage in multiple financing and other transactions that helped complete the second SPACs' business combination. The SEC alleged that RTW did not timely or adequately disclose these conflicts to the fund boards and omitted material information regarding the SPAC investments to current and prospective fund investors. The SEC further faulted RTW for failing to adopt and implement compliance procedures concerning the firm's SPAC sponsorship and investment activities. In addition, RTW failed to timely file accurate reports on Schedule 13G concerning the beneficial ownership of the common stock of a public company formed as a result of a SPAC business combination. The firm agreed to a censure and $1.4 million penalty.

SEC Litigation Release – https://www.sec.gov/enforce/34-97622-s

Valuation

Mispricing and Net Asset Value (***NAV***) Calculations (June 16, 2023)

In February 2022, the SEC charged James Velissaris, the former Chief Investment Officer of Infinity Q Capital Management, LLC, (***Infinity Q***) the manager of the Infinity Q Diversified Alpha mutual fund, and Infinity Q Volatility Alpha private fund, with overvaluing assets by more than $1 billion and collecting more than $26 million in fees and ill-gotten profits. In November 2022, the SEC brought a settled action against the mutual fund under Rule 22c-1 of the Company Act for mispricing its NAV and appointed a special master over the fund to oversee the return of remaining funds to harmed investors. In June 2023, the SEC filed a settled action against Infinity Q for its role in the massive over-evaluation scheme. Infinity Q was charged with violating the antifraud provisions of Section 17(a) of the Securities Act of 1933 (***Securities Act***) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as violations of the books and records, anti-fraud and compliance rule provisions of the Advisers Act. The manager was also charged with aiding and abetting the mutual fund's violation of the pricing provisions of the Company Act. Infinity Q has settled the charges by consenting to the appointment of a monitor subject to court approval. (See summaries in the *Q1 2022* and *Q4 2022* CORE Regulatory Updates.)

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25750

Market Manipulation

Abusive Naked Short Selling Scheme (June 12, 2023)

Sabby Management LLC and it managing partner, Hal D. Mintz, were charged with illegal "naked short selling" in two private funds the firm managed. In legal short sales, a trader must either own or borrow, arrange to borrow, or have reasonable grounds to believe that the securities can be borrowed (*i.e.*, "locate") a security from a securityholder when selling the security short. However, according to the SEC's complaint, Sabby and Mintz regularly circumvented trading rules to conduct unlawful trades in the stock of at least 10 public companies. The

defendants improperly placed short sales when they knew or were reckless in not knowing that they had not borrowed or located the shares. They then failed to make timely delivery of the shares. Their fraudulent scheme was designed to earn profits that could not have been gained through legal trading. The complaint further alleges that Sabby and Mintz used their naked short selling to artificially deflate the price of securities, allowing them to obtain more shares at a cheaper price. They tried to conceal their fraudulent trading by mismarking short sales as "long" and using securities acquired after the trades to make it appear to brokers executing the trades that they had complied with the requirement to have borrowed or located the shares prior to their trades. When questioned by brokers about their trading, they repeatedly lied. The SEC charged Sabby and Mintz with violations of Section 10(b) of the Exchange Act and Rules 10b-5 and 1-b-21 thereunder as well books and records and compliance rule failures under Rules 204-2 and 206(4)-7 of the Advisers Act. Mintz was charged with aiding and abetting the violations. The case is being litigated and the SEC is seeking permanent injunctive relief, disgorgement, prejudgment interest, and civil penalties.

SEC Press Release – https://www.sec.gov/news/press-release/2023-107

Social Media Influencer in Stock Manipulation Scheme (May 26, 2023)

The SEC announced settled charges against Francis Sabo, known as "Ricky Bobby," in a $100 million securities fraud scheme in which he, along with several other defendants previously charged by the SEC, used social media platforms to manipulate exchange-traded stocks. Sabo cultivated a substantial following in a free online forum purported to provide educational content about trading and securities markets. Using the forum, Atlas Trading on Discord, Sabo purchased stocks and then encouraged his followers to buy those selected stocks. He posted price targets or indicated that he was buying, holding, or adding to his stock positions. When share prices and/or trading volumes rose, Sabo routinely sold his shares without disclosing his plan to dump the securities. At the same time, he continued to promote them. In a matter of a two years, Sabo made over $1 million from his participation in this stock manipulation scheme. According to the SEC complaint, Sabo violated the antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as well as Section 17(a) of the Securities Act. The complaint sought a permanent injunction, disgorgement, prejudice interest, and civil penalties. In settling the charges, Sabo was enjoined from future violations of the federal securities laws, with the amount of monetary remedies yet to be determined. The settlement is subject to court approval. A parallel action brought by the Criminal Fraud Section of the U.S. Department of Justice and the U.S. Attorney's Office sought criminal charges for the unlawful activity. The investigation resulted from a referral from the Exam Division.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25736

Cherry Picking

Fraudulent Cherry-Picking Scheme (May 5, 2023)

Investment adviser, Matthew J. Werthe (dba HSR Wealth Management) was charged by the SEC with defrauding clients in a cherry-picking scheme. Werthe was relatedly charged for making false and misleading statements regarding the matter. Werthe placed securities trades using a block trading account, intended for the purpose of facilitating securities purchases for multiple clients. Werthe placed trades early in the trading day but did not allocate the trades to his and his clients' accounts until later in the day. He disproportionately allocated profitable trades to himself and unprofitable trades to his clients' accounts. His dubious allocations resulted in $450,000+ in personal ill-gotten gains at the expense of his clients. Additionally, Werthe made false and misleading statements to clients and prospective clients regarding his personal trading, his trading for clients, and his reasons for switching the clients' account to a new broker-dealer custodian. He was charged with violating the antifraud provisions of Section 10(b) of the Exchange Act and Rules 10b thereunder, Sections 17(a) of the Securities Act and Sections 206(1) and 206(2) of the Advisers Act. The complaint sought a permanent injunction, a conduct-based injunction, disgorgement with prejudgment interest, and civil penalties. Litigation is pending.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25710

Regulatory Updates and Enforcement

Unregistered Broker-Dealer

Fund Microcap Transactions & Unregistered Dealer Activities (June 1, 2023)

The SEC announced charges against Auctus Fund Management LLC and its co-owners Alfred Sollami and Louis Posner for failing to register as securities dealers with the SEC. The men allegedly bought and sold billions of newly-issued shares of microcap securities through their fund, generating millions in profit, without registering as dealers or associating with a registered dealer as required by federal securities laws. The defendants purchased convertible notes and associated warrants from microcap issuers and converted the notes into shares of stock at a large discount from the market price. Sollami and Posner sold the newly issued shares into the market at significant profit. Using Auctus Funds as their vehicle, they purchased notes from more than 150 issuers and sold more than 60 billion shares of newly issued stock into the market, generating profits of more than $100 million. By failing to register the defendants avoided legal obligations for securities dealers that govern their conduct in the marketplace and protect the investing public including regulatory inspections, oversight, financial responsibility requirements, and books and records requirements. The SEC is seeking permanent injunctions, disgorgement, prejudgment interest, civil penalties, penny stock bars and other equitable relief for violations of Sections 15(a)(1) and 20(b) of the Exchange Act. Actus Fund was also named as a relief defendant in the case, with disgorgement sought from the fund as well as from the manager, Sollami and Posner.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25741

Sale of Fund Interests by Unregistered Broker-Dealers (May 19, 2023)

A May complaint filed by the SEC charged Daniel E. Levin with unlawful action for imploring investors to purchase $2.6 million worth of units in his personally controlled CRP Fund, which owned units in funds run by GPC Capital, which the SEC previously charged in February 2021 with running a Ponzi scheme. The SEC charged Levin with soliciting investments from at least 27 investors without being properly registered as a broker-dealer. By engaging in solicitation activities, he was required to register with the SEC and maintain a brokerage license, which he failed to do. Levin violated section 15(a) of the Exchange Act. Levin consented to a bifurcated settlement agreeing to be permanently enjoined from violations of federal securities laws and agreeing to a monetary settlement in an amount to be determined by the court.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25731

Cross Trades

Improper Rebalancing Transactions & Inflated NAVs (April 3, 2023)

The SEC brought charges against Chatham Asset Management, LLC (***Chatham***) and Anthony Melchiorre, its founder and principal owner. Chatham managed a number of private hedge funds and also served as adviser or sub-adviser to a number of "liquid alternative funds[1]", some of which were registered investment companies under the Company Act (***RICs***). Melchiorre traded on behalf of fund clients in three high-yield debt securities issued by American Media Inc. (***AMI***), a subsidiary of AMI Parent Holdings (***AMI Bonds***). The AMI Bonds generally were illiquid investments and traded over the counter. There were few purchasers of the AMI Bonds other than the Chatham funds. The defendants engaged in what were effectively cross transactions in these AMI debt securities that resulted in one Chatham fund selling AMI Bonds and a different Chatham fund purchasing the same bonds through various broker-dealers (***Rebalancing Trades***). Chatham engaged in the Rebalancing Trades to address portfolio constraints such as industry or issuer fund concentration limits, to meet investor redemptions, and to allocate capital inflows and outflows. Recognizing that there were legal restrictions on trading between RICs and their affiliates, which included other Chatham funds, Chatham and Melchiorre sought advice from a compliance consultant on how to facilitate the Rebalancing Trades. The consultant advised Chatham to conduct the trading either through a single broker over more than one day or through multiple brokers if on the same day. The foundational principle underlying the advice was to ensure that the transactions occurred at

[1] Liquid alternative funds are mutual funds that seek to implement hedge fund-like strategies while maintaining daily liquidity

independently-derived market prices. Chatham and Melchiorre generally followed the compliance consultant's advice and executed Rebalancing Trades through a small number of broker-dealer firms (***Rebalancing Brokers***). However, the Rebalancing Trades were executed at prices proposed by Melchiorre and agreed to by the Rebalancing Brokers, not at prices that were independently derived from price discovery in the broader market. The Rebalancing Brokers engaged in the Rebalancing Trades because they expected Melchiorre to repurchase the bonds. According to the SEC order, while several of the Rebalancing Brokers sought to "match" buy and sell orders from their customers, the vast majority of the Rebalancing Trades involved at least one Rebalancing Broker that purchased bonds into its firm's inventory. Some of the Rebalancing Brokers would at times agree to purchase securities from Chatham even though the Rebalancing Broker may not have lined up the other leg of the transaction. These brokers' willingness to do so was based on their expectation that Chatham would repurchase the bonds, either directly or through another broker. Melchiorre reportedly proposed the price for the Rebalancing Trades and the Rebalancing Brokers agreed to it without first soliciting bids from other market participants. When proposing a price for Rebalancing Trades, Melchiorre considered a number of factors, which included the prior day's price as reflected in prices published by a pricing service. Those published prices would have been influenced, to some extent, by Chatham's own trading. When purchasing the AMI Bonds, Melchiorre also added a spread to compensate the Rebalancing Brokers. Over time, the prices at which the Rebalancing Trades were executed increased at a higher rate than the prices of similar securities. Chatham's trading in the AMI Bonds accounted for more than 80% of the trading in those bonds. Chatham and Melchiorre calculated the NAV of their client funds' holdings using pricing data that was based, in part, on the trading prices of the AMI Bonds. The SEC noted that the fund NAV's were therefore higher than they would have been if the Rebalancing Trades were removed from the AMI Bond market. This resulted in the Chatham funds paying $11 million more in performance or management fees than they would have paid in the absence of the Rebalancing Trades. The SEC charged Chatham and Melchiorre with Section 206 violations under the Advisers Act and with aiding and abetting violations of the Company Act for illegal affiliated cross transaction without complying with exemptions under Rule 17a-7 or obtaining an exemptive order from the SEC. The defendants agreed to jointly pay disgorgement plus prejudgment interest of $14.375 million to be returned to affected investors through a distribution plan. Chatham and Melchiorre agreed to pay civil penalties of $4,400,000 and $600,000, respectively and were both prohibited from holding certain positions in the investment industry.

SEC Litigation Release – https://www.sec.gov/news/press-release/2023-72

Electronic Communications

$4 Million Settlement for Lost Emails (June 22, 2023)

The SEC charged J.P. Morgan Securities (***JPMorgan***) for deleting approximately 47 million electronic communications in about 8,700 electronic mailboxes over a 4-month period in 2018, including many which were business records required to be retained under books and records rules. The firm began a project working together with a vendor engaged to handle electronic communications archiving to delete older communications from the 1970s and 1980s. and documents that were no longer required to be retained. However, the project experienced glitches with documents intending to be deleted not expunged. In June 2019, while troubleshooting the issue, employees inadvertently deleted electronic communications from the first quarter of 2018, wrongly believing based on representations from the firm's third-party archiving vendor that the records were stored in a way to prevent permanent deletion of the records until after the retention period had passed. However, the vendor had not properly set up the default retention settings in a particular email domain, resulting in all emails in that domain during the period that were not subject to legal holds being deleted. The issue was not immediately detected but was later discovered by JPMorgan's legal discovery team. Despite the team's efforts to recover the communications they were determined permanently unrecoverable. As a result, the firm was unable to produce communications that were responsive to multiple subpoenas and other document requests by the SEC and other regulators. The firm was censured and ordered to pay a $4 million penalty.

SEC Litigation Release – https://www.sec.gov/files/litigation/admin/2023/34-97787.pdf

Widespread Recordkeeping Failures (May 11, 2023)

In response to the SEC's public announcement encouraging firms to undertake a self-review of whether employees had business communications using unapproved channels, HSBC Securities (USA) Inc. and Scotia Capital (USA) Inc. each uncovered pervasive and long-standing use of off-channel communications at their respective firms. Troubled behaviors included using personal devices to communicate with other employees about the firm's securities business and using messaging platforms such as What'sApp for business communications. Neither firm was able to preserve the majority of these communications as required by federal securities laws. The failings involved employees at all levels of authority including supervisors and senior executives. Both firms cooperated with the SEC investigation by reporting their recordkeeping failures and gathering example communications from the personal devices of firm employees. The firms' efforts to self-report and self-remediate their violations reduced their penalties. Both firms were charged with violating certain recordkeeping provisions of the Exchange Act and failing to reasonably supervise, with a view to prevent and detect violations. In addition to substantial financial penalties ($15 million for HSBC and $7.5 million for Scotia), both firms were ordered to cease and desist from committing such violations and were censured. Both firms agree to retain compliance consultants to conduct comprehensive reviews of their policies and procedures related to the retention of electronic communications found on personal devices and related to disciplinary measures for non-compliant employees.

SEC Press Release – https://www.sec.gov/news/press-release/2023-91

FCPA Violations

Dutch Medical Supplier to Pay $62 Million to Settle FCPA Charges (May 11, 2023)

The SEC announced that Amsterdam-based Koninklijke Philips N.V. will pay more than $62 million to resolve charges that it violated the Foreign Corrupt Practices Act (***FCPA***) with respect to conduct related to its sales of medical diagnostic equipment in China.

According to the SEC's order, Philips' subsidiaries in China, cumulatively referred to in the order as Philips China, used special price discounts with distributors that created a risk that excessive distributor margins could be used to fund improper payments to government employees. The SEC's order also found that employees, distributors, or sub-dealers of Philips' subsidiaries in China engaged in improper conduct to influence hospital officials to draft technical specifications in public tenders to favor Philips' products. For example, the order found that, in one instance, a district sales manager at Philips China provided funds to a hospital director in return for the director's assistance in the procurement process, and, in another instance, Philips China employees discussed tailoring technical specifications for a public tender with hospital directors so that only Philips China and two other manufacturers would qualify for the bid.

The order further found that the employees, distributors, or sub-dealers engaged in improper bidding practices by preparing additional bids with other manufacturers' products to create the appearance of legitimate public tenders and to meet the minimum bids requirement under Chinese public tender laws.

"This matter highlights the need for companies to design and implement internal accounting controls sufficient for the scale of their business. Despite remediation done in connection with its prior violations, Phillips nevertheless failed over the course of several years to implement sufficient internal accounting controls with respect to its sales of medical technology products in China," said Charles Cain, Chief of the SEC Enforcement Division's FCPA Unit. In April 2013 the Commission charged Philips in connection with similar misconduct in Poland that had occurred between 1999 and 2007.

Philips consented to the SEC order without admitting or denying the findings that it violated the books and records and internal accounting controls provisions of the Exchange Act and agreed to pay $15 million in civil penalties and more than $47 million in disgorgement and prejudgment interest.

As a reminder, the FCPA makes it unlawful for any U.S. company – as well as any of its officers, directors, employees, agents or stockholders acting on its behalf – to offer, pay, promise or authorize any bribe, kickback

or similar improper payment to any foreign official, foreign political party or official or candidate for foreign political office in order to assist the U.S. company in obtaining, retaining or directing business.

The FCPA not only prohibits direct payments to a foreign official, but also prohibits U.S. companies from making payments to third parties – such as a foreign partner, sales agent or other intermediary – with knowledge that all or a portion of the payment will be passed on to a foreign official. Accordingly, before any company retains any agent or intermediary who may be involved in soliciting a potential investment from, or other transaction with, a foreign government or government entity, the company's CCO and/or outside counsel should be consulted.

SEC Press Release – https://www.sec.gov/news/press-release/2023-92

Miscellaneous Enforcement

Private Fund Offering Fraud (June 23, 2023)

The SEC charged Michael Wayne Williams, an investment adviser formerly registered with the State of Georgia, and two of his businesses, Highguard Capital, LP and Guardian Opportunity Management, LP, with conducting a multipart offering fraud. Williams and Highguard sold more than $1.8 million of securities interests to investors in Guardian Opportunity Management, the investment manager for Guardian Opportunity Fund, a private fund Williams was starting. He fraudulently represented that investors' money would be used to launch and grow the Guardian Opportunity Fund. However, he instead diverted a large portion of the invested money to repay investors in three prior funds he was closing. Additionally, Williams obtained $16 million from investors using false performance returns. Finally, the SEC's complaint stated that Williams and Highguard Capital fraudulently sold over $1 million of securities interests in Guardian Opportunity Management to a woman, telling her that funds would be used to grow the Guardian Opportunity Fund. Instead her money was diverted to repay earlier Guardian Opportunity Management investors. Williams, Guardian Opportunity Management, and Highguard Capital were charged with violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as well as Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Litigation is pending and the SEC is seeking permanent injunctive relief, disgorgement with prejudgment interest and civil penalties against all defendants.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25752

Fraudulent Fund Offering Involving Carbon Capture Units (May 8, 2023)

A SEC complaint alleged that Roy W. Hill and Eric N. Shelly, through two entities they controlled, engaged in fraudulent offerings that raised over $155 million from over 500 investors. An emergency action temporarily restrained the defendants' ongoing offerings and froze their assets. The two defendants and their entities, Clean Energy Technology Association Inc. (CETA) and Freedom Impact Consulting, LLC (FIC) offered investments claiming that investor money would be used to purchase devices that CETA referred to as carbon capture units (CCUs). CETA claimed that it built the units and leased them to oil and gas producers to enhance the recovery and marketability of oil and gas. The defendants falsely represented that CETA and FIC would pay investors returns representing a share of the revenues earned from operating the CCUs. Hill and Shelly also lured investors with false claims that the CCUs were patented, that one of the largest oil and gas companies in the world was a customer, and that funds sponsored by FIC consistently generated 10% quarterly returns. In reality, CETA had received no material revenues from CCU operations, and the quarterly distributions made to investors were sourced from other investors' capital. In addition, Shelly and FIC provided investors with false financial statements reflecting non-existent economic activity and investment returns. Hill, Shelly, CETA, and FIC were charged with violating antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The complaint sought permanent injunctions, disgorgement with prejudgment interest, and civil penalties for all defendants. Litigation in the matter is on-going.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25712

Liquidity Rule Violations (May 5, 2023)

Section 22(e) of the Company Act requires registered investment companies to satisfy a shareholder's redemption request within seven days. In 2016, the SEC adopted Rule 22e-4 under the Company Act (the ***Liquidity Rule***) that requires mutual funds to manage liquidity risk by, among other things, establishing a written program (the Liquidity Risk Management Program or "***LRMP***") to classify the liquidity of portfolio investments according to defined categories and limit the percentage of the portfolio invested in illiquid investments to 15%. Fund boards must provide general oversight with respect to the LRMP. The Liquidity Rule also requires a fund to take prompt remedial steps if they hold illiquid investments above the percentage limit. Private funds are not subject to the Liquidity Rule but open-end private funds do have obligations to manage liquidity to satisfy redemption rights as established under fund governing documents. In the first-ever case enforcing the Liquidity Rule, the SEC charged mutual fund manager Pinnacle Advisors, LLC (***Pinnacle***) and several members of Pinnacle's leadership for failure to fulfill requirements under the Rule. Two Pinnacle independent trustees, Mark Wadach and Lawton "Charlie" Williamson were charged with aiding and abetting Liquidity Rule violations as were two officers, Robert Cuculich and Benjamin Quilty. A third trustee, Joseph Masella, was charged with causing and willfully counseling the firm on activity that resulted in the Liquidity Rule violations. For at least a year, the fund improperly held 21%-26% of its net assets in illiquid investments. Pinnacle and it officers classified the fund's largest illiquid investment as "less liquid" ignoring restrictions, transfer limitations, and the absence of a market for the shares. They disregarded the advice of fund counsel and auditors. Pinnacle officers failed to present the board with a plan to reduce the illiquid investments to 15% or lower and failed to make required SEC filings. Cuculich, Quilty, and Masella misled the SEC's Division of Investment Management about the basis for the fund's liquidity classifications. The board had oversight responsibilities that went unmet by Wadach and Williamson who knew that the shares were restricted and illiquid. By ignoring the situation, they aided and abetted the funds' violation. The fund which is now a liquidating trust was not separately charged. Litigation is pending in the primary action against Pinnacle and the SEC is seeking permanent injunctions and civil penalties. Masella consented to an order requiring him to cease and desist, pay a civil penalty of $20,000, and accept a six-month affiliation suspension.

In a separate case not directly related to the Liquidity Rule charges, Pinnacle Investments LLC, a dually-registered investment adviser and broker-dealer affiliate of Pinnacle, settled charges against the firm for making false and misleading statements in its Form ADV brochure regarding client account review, failing to disclose conflicts of interest, failing to implement policies and procedures, and failing to share with clients required information about advisory personnel. The firm had previously been cited by SEC exam staff for failing to have a qualified CCO and conduct sufficient reviews of advisory accounts and the SEC's current action was based in part on recidivist violations. The firm settled the case by accepting a cease and desist and a censure, and by paying disgorgement and a civil penalty of approximately $476,000.

SEC Press Release – https://www.sec.gov/news/press-release/2023-90

Other Regulatory Developments

Anti-Money Laundering (AML) & Sanctions Developments

Corporate Transparency Act and Beneficial Ownership Information Reporting

On August 1, a bipartisan bill was introduced to modify the Corporate Transparency Act (***CTA***). The Protect Small Businesses and Prevent Illicit Financial Activity Act (H.R. 5119) was introduced in the U.S. House of Representatives. H.R. 5119 proposes to give those subject to the new beneficial ownership information (***BOI***) reporting requirements (*i.e.* most small corporations and LLCs) an additional year to provide BOI to FinCEN pursuant to the CTA. The sponsors of H.R. 5119 believe the current proposal will give small businesses sufficient time and information to comply with the CTA's requirements.

Under the CTA, entities that are incorporated or registered to do business in a U.S. state or tribal jurisdiction (***Reporting Companies***) will be required to file BOI on the Beneficial Ownership Secure System, which is

scheduled to launch January 1, 2024 (the ***Effective Date***). SEC-registered investment advisers, venture capital fund advisers filed as exempt reporting advisers (***ERAs***) with the SEC, certain pooled investment vehicles, and subsidiaries of certain exempt entities (including general partners and managing members of exempt pooled investment vehicles), are among the 23 categories of entities specifically exempted from beneficial ownership information reporting requirements. Other notable exemptions to reporting requirements include "large operating companies", which applies to companies that employ more than 20 employees on a full-time basis in the U.S., maintain an operating presence at a physical office in the U.S., and filed a U.S. federal income tax return for the previous year showing more than $5 million in gross receipt or sales from operations in the U.S. It should be noted that there are potentially several categories of investment advisers that are not specifically exempted from BOI reporting, including: 1) state-registered advisers; 2) all ERAs that only file with a state regulator; and 3) ERAs with the SEC that manage less than $150 million in private fund assets and rely on the private fund exemption. In addition, this potentially may include certain private funds or pooled vehicles that do not satisfy the Section 3(c)(1) or 3(c)(7) exemption from registration under the Company Act, as the exemption for pooled investment vehicles seems to only contemplate those private funds.

As of now, Reporting Companies created after the Effective Date have 30 days to report from the day of formation, and the deadline for existing businesses to report is January 1, 2025. H.R. 5119, if passed, would extend the deadline to 60 days for entities formed after the Effective Date and extend the filing deadline for entities created prior to the Effective Date by an additional year (*i.e.,* January 1, 2026).

In addition to extending the reporting deadline, H.R. 5119 also proposes to strengthen disclosure rules by barring FinCEN from giving Reporting Companies the option of responding "unknown" or "unable to identify" to BOI reporting questions. This would close a loophole that critics of the CTA have identified as a way for criminals to avoid the CTA's reporting requirements and thereby undermine the CTA's underlying intent.

We encourage those who will be subject to the new reporting requirements, in particular those with a large number of legal entities in their structures, to continue analyzing each legal entity and collecting BOI for eventual reporting, regardless of reporting deadline and/or ability to claim an exemption. Additional information on the reporting requirements, including what to report and how, is available here: https://www.fincen.gov/boi.

OFAC Settles with Poloniex, LLC for $7.5 Million Related to Apparent Violations of Sanctions Programs (05/01/23)

The U.S. Department of the Treasury's Office of Foreign Assets Control (***OFAC***) announced a settlement with Poloniex, LLC (***Poloniex***), a Delaware company with its principal place of business in Boston, Massachusetts that operated an online trading and settlement platform. Poloniex agreed to remit $7,591,630 to settle its potential civil liability for apparent violations of sanctions against Crimea, Cuba, Iran, Sudan, and Syria. Between January 2014 and November 2019, the Poloniex trading platform allowed customers apparently located in sanctioned jurisdictions to engage in online digital asset-related transactions—consisting of trades, deposits, and withdrawals—with a combined value of $15,335,349, despite having reason to know their location based on both Know Your Customer (***KYC***) information and internet protocol address data. The settlement amount reflects OFAC's determination that Poloniex's apparent violations were not voluntarily self-disclosed and were not egregious.

All U.S. persons must comply with OFAC regulations, including all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, all U.S. incorporated entities and their foreign branches, including in certain instances, foreign subsidiaries owned or controlled by U.S. companies.

https://ofac.treasury.gov/recent-actions/20230501_33

FinCEN Assesses $1.5 Million Penalty against Kingdom Trust Company for Violations of Bank Secrecy Act (April 26, 2023)

The Financial Crimes Enforcement Network (***FinCEN***) assessed a $1.5 million civil money penalty on South Dakota-chartered The Kingdom Trust Company (***Kingdom Trust***) for willful violations of the Bank Secrecy Act (***BSA***) and its implementing regulations. This is FinCEN's first enforcement action against a trust company.

"Kingdom Trust had virtually no process to identify and report suspicious transactions, resulting in it processing over $4 billion in international wires with essentially no controls," said FinCEN's Acting Director Himamauli Das. "This enforcement action is an important statement that we will not tolerate trust companies with weak compliance programs that fail to identify and report suspicious activities, particularly with respect to high-risk customers whose businesses pose an elevated risk of money laundering."

Kingdom Trust admits that it willfully failed to accurately and timely report hundreds of transactions to FinCEN involving suspicious activity by its customers, including transactions with connections to a trade-based money laundering scheme and multiple securities fraud schemes that were the subject of both criminal and civil actions. These failures stemmed from Kingdom Trust's severely underdeveloped process for identifying and reporting suspicious activity. Kingdom Trust is a trust company organized under the laws of the state of South Dakota and therefore a "bank," as defined by the BSA and its implementing regulations. As such, Kingdom Trust is required to comply with applicable BSA regulations, including the requirement to report suspicious activity to FinCEN.

Note: Investment advisers and the funds they manage do not currently fall under the definition of "bank" or "financial institution" and are therefore not currently subject to the BSA.

https://www.fincen.gov/news/news-releases/fincen-assesses-15-million-civil-money-penalty-against-kingdom-trust-company

Digital Asset Developments

Bitcoin Breaks Barriers, Attracting Attention of Institutional Investors / Ethereum Upgrades

During Q2 2023, the cryptocurrency market experienced a mix of highs and lows. Bitcoin, the leading cryptocurrency, saw increased institutional adoption as several major financial institutions announced plans to offer Bitcoin custody and trading services to their clients. Additionally, Ethereum's long-awaited upgrade to Ethereum 2.0 continued to progress, aiming to improve the network's scalability and sustainability.

As inflation refuses to give way to interest rate hikes across the globe, Bitcoin's characteristics seem more appealing to some institutional investors. An important attribute of Bitcoin lies in its constrained supply, as Bitcoin's computer algorithm mandates a fixed cap of 21 million digital coints. This scarcity implies inflation immunity, which, when combined with the decentralized structure of Bitcoin, enhances its perceived value and underscores the possibility of appreciation over time.

Moreover, Bitcoin has garnered recognition as an alternative investment avenue and a tool for diversification. Its allure has captivated certain institutional investors such as hedge funds, technology firms and even some governmental entities. Such investors are delving into Bitcoin for various reasons:

- Diversification and Portfolio Management: Financial institutions seek to diversify their investment portfolios and view cryptocurrencies as an alternative asset class that can potentially provide attractive returns and reduce overall portfolio risk.
- Client Demand and Retention: Many retail clients have expressed interest in Bitcoin and other cryptocurrencies. Financial institutions aim to meet this demand and retain their clients by offering cryptocurrency-related services and investment opportunities.
- Hedge Against Economic Uncertainty: Some financial institutions view Bitcoin as a potential hedge against economic uncertainty and inflation. They perceive Bitcoin's decentralized nature and limited supply as features that can protect against the devaluation of traditional currencies and safeguard wealth.
- Potential Returns: The historical performance and volatility of Bitcoin have magnetized some investment firms, lured by the prospect of substantial returns. Bitcoin is perceived as a speculative investment avenue that, with adept management, can potentially yield remarkable profits.

https://www.nasdaq.com/articles/breaking-barriers-how-bitcoin-is-creating-opportunities-for-institutional-investors

Regulatory Updates and Enforcement

Interest in Bitcoin from institutional investors has gone up and down during and since the COVID-19 pandemic. Despite several scandalous bankruptcies of crypto-focused firms, Bitcoin price has been relatively stable throughout Q2 2023, starting the quarter at ≈ $28,500/Bitcoin and finishing the quarter at ≈ $30,500/Bitcoin. Future interest rate hikes by the Federal Reserve Bank and its foreign peers may impact whether institutional investors dip their toes into the Bitcoin market or stick to more traditional equity investments.

SEC Charges Operators of Websites with Offering Fraud Involving Crypto Assets (05/11/23)

The SEC filed charges against GA Investors and John Does 1-4 for engaging in fraudulent securities offerings, including crypto asset mining pools, through numerous websites. The SEC is seeking immediate action to shut down these fraudulent websites. The defendants allegedly used various websites, including GA-Investors.org, to offer high returns of up to 61.9% within 24 hours for investments in various securities. Some of these websites even impersonated legitimate companies, including a registered broker-dealer. The defendants targeted investors globally, including in the US, and managed to collect around $85,000 for their fraudulent securities offering. The GA Investors website promised daily returns between 2% and 4.5%. Investors were instructed to buy crypto assets from a separate platform and transfer them to a GA Investors wallet address. Although some small withdrawals were allowed, when investors attempted to retrieve larger amounts, their accounts were frozen and their funds were misappropriated by the defendants.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25721

The Hydrogen Technology Corporation (05/26/23)

The SEC obtained final consent judgments against The Hydrogen Technology Corporation, its former CEO, and the CEO of Moonwalkers Trading Limited. The judgments conclude the SEC's case against them for unregistered offers and sales of crypto asset securities named "Hydro" and manipulating trading volume and price, resulting in over $2 million profit for Hydrogen. The defendants were ordered to pay nearly $3 million in disgorgement, prejudgment interest, and penalties. The SEC's complaint states that the defendants created the Hydro token in 2018, distributed it, and later hired Moonwalkers to create an impression of robust market activity, which artificially inflated Hydro's price and enabled a profitable sale of the crypto asset. The offenders without admitting wrongdoing, agreed to permanent injunctions against violating securities laws and ordered payments.

SEC Litigation Release – https://www.sec.gov/litigation/litreleases/lr-25737

SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (06/05/23)

The SEC charged Binance Holdings Ltd., (***Binance***) the operator of the world's largest crypto trading platform Binance.com, its U.S.-based affiliate BAM Trading Services Inc., which together with Binance, operates the crypto asset trading platform, Binance.US, and their founder (Changpeng Zhao) with 13 violations of securities laws. The SEC alleged that Binance deceived investors by allowing high-value U.S. customers to trade on Binance.com despite claims to the contrary, and secretly controlling the operations of Binance.US while portraying it as independent. It's also claimed that Binance controlled customer assets, including diverting them to an entity owned by the founder. BAM Trading, its affiliate BAM Management US Holdings, Inc., and the founder are accused of misleading investors about trading controls and involvement in manipulative trading. The charges include operating unregistered securities exchanges, broker-dealers, and clearing agencies, as well as unregistered offers and sales of crypto assets. The SEC's complaint highlights numerous deceptive practices and conflicts of interest, including unregistered exchange, broker, and clearing agency, unregistered offer and sale of crypto assets, failure to restrict U.S. investors from accessing binance.com, and intentionally misleading investors. Gurbir S. Grewal, Director of the SEC's Enforcement Division, stated: "By engaging in multiple unregistered offerings and also failing to register while at the same time combining the functions of exchanges, brokers, dealers, and clearing agencies, the Binance platforms under Zhao's control imposed outsized risks and conflicts of interest on investors. Those risks and conflicts are only heightened by the Binance platforms' lack of transparency, reliance on related-party transactions, and lies about controls to prevent manipulative trading. Despite their years-long efforts to not be held accountable, today's complaint begins the process of doing so."

SEC Press Release – https://www.sec.gov/news/press-release/2023-101

Regulatory Updates and Enforcement

Recent Trends in Enforcement Cases

The ongoing debate continues as to whether cryptocurrency should be classified as a security regulated by the SEC, a commodity regulated by the CFTC, a currency, or something else. A recent and greatly anticipated court ruling in one SEC enforcement case provided some mixed signals regarding the SEC's authority over cryptocurrencies. In December 2020, the SEC filed a lawsuit against Ripple Labs Inc. (***Ripple***) and two executives alleging that the Ripple executives raised over $1.3 billion through an unregistered digital asset offering, XPR. The SEC contended that XRP should be considered a security, making Ripple's sale of XRP subject to registration requirements and investor protection regulations. Following a lengthy court battle, on July 13, 2023, US District Judge Analisa Torres of the Southern District of New York (***SDNY***) ruled that the XRP token constitutes a security when sold directly to hedge funds and other institutions, but not when offered directly to the public on cryptocurrency exchanges. In a decision 18 days later, Judge Jed Rakoff – also of the SDNY – in *SEC v. Terraform Labs Pte. Ltd.,* concluded that platform-based sales did comprise securities and rejected the approach adopted in the Torres ruling. Accordingly, in an August 9, 2023 letter to Judge Torres, the SEC alerted the SDNY of its intent to seek leave to file an interlocutory appeal of the court's decision in the Ripple case. For now, the ongoing legal battle as to the status of cryptocurrency transactions, and the implications for investment advisers and others in how to treat cryptocurrency, particularly for purposes of employee reporting under investment advisers' Code of Ethics, continues unresolved.

Regulatory bodies such as the SEC, FinCEN, and international counterparts are addressing various aspects of cryptocurrency activities to promote investor protection, prevent illicit activities, and maintain market integrity. Some notable trends include:

- AML and KYC Compliance: Regulatory agencies are enforcing stricter AML and KYC compliance on cryptocurrency exchanges and service providers. This includes measures to prevent money laundering, terrorism financing, and other illicit activities through digital assets.
- Enforcement Tools and Technology: Regulatory agencies are enhancing their enforcement capabilities by investing in technology, data analytics, and blockchain analysis tools to track and trace illicit crypto transactions.
- Cross-Border Collaboration: Given the global nature of cryptocurrencies, international regulatory collaboration is increasing. Regulatory agencies from different jurisdictions are sharing information and coordinating efforts to address cross-border fraud, money laundering, and other illicit activities.
- Education and Investor Protection: Regulatory agencies are prioritizing investor education to raise awareness about the risks associated with investing in cryptocurrencies. This includes issuing alerts about potential scams, fraudulent schemes, and providing guidance on how to make informed investment decisions.

Finally, recent trends in cryptocurrency enforcement cases demonstrate a concerted effort by regulatory agencies to adapt to the dynamic crypto landscape. The focus is on bringing transparency, accountability, and compliance to the forefront to ensure the long-term viability of the cryptocurrency market.

Privacy Law Developments

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

Indiana

The Indiana Data Privacy Law was signed in May 2023 and becomes effective January 1, 2026. The law is similar to other state privacy laws and applies to persons or entities who conduct business in Indiana or produce products or services that target residents of Indiana. Businesses that control or process personal data of at least 100,000 Indiana residents or at least 25,000 Indiana residents and derive over 50% of gross revenue from the sale of personal data. Notably, the Indiana Data Privacy Law does not have a revenue threshold for entities to be subject

to privacy obligations. However, the law does not apply to those financial institutions and their affiliates that are subject to the Gramm-Leach-Bliley Act (***GLBA***).

https://iga.in.gov/legislative/2023/bills/senate/5

Montana

Similar to the state laws discussed above, the Montana Consumer Data Privacy Act (***MCDPA***) was passed in April 2023 and is effective October 1, 2024, with compliance required by January 1, 2025. The MCDPA would apply to entities that (i) conduct business in Montana or produce services or products targeting Montana residents and (ii) control or process personal data of at least (a) 50,000 Montana residents (excluding data processed for the purpose of payments or (b) 25,000 Montana residents and derive more than 25% gross revenue from sale of personal data. This legislation exempts both data and financial institutions and affiliates that are governed by or subject to GLBA, thus is not likely to be applicable to RIAs or ERAs.

https://leg.mt.gov/bills/2023/billpdf/SB0384.pdf

Tennessee

Tennessee's Privacy Protection Act (***TIPA***) was approved in April 2023 and goes into effect July 1, 2025. The Act provides several thresholds for applicability that will generally exclude most advisers from its application. TIPA would only apply to a company that is (i) either located in Tennessee or targeting Tennessee residents with products and services, (ii) exceeds $25 million in annual revenue, and (iii) in a calendar year either (a) controls or processes at least 25,000 consumers' personal information *and* derives over 50% of its revenue from the sale of personal information or (b) controls or processes such data for at least 175,000 consumers.

Tennessee's law provides a unique safe harbor, allowing an affirmative defense to the state's claims of noncompliance if the entity adopts and enforces a privacy program that reasonably conforms to current and updated frameworks and standards set by the National Institute of Standards and Practices (***NIST***). It also provides exclusions for data businesses subject to GLBA and data covered by Regulation S-P.

http://www.capitol.tn.gov/Bills/113/Bill/SB0073.pdf

Texas

In May 2023, Texas lawmakers successfully proposed and approved comprehensive consumer privacy legislation, which was enacted in July 2023 and will take effect July 2024. The Texas Data Privacy and Security Act (***TDPSA***) is modelled after Virginia's consumer privacy law and similarly business-friendly, providing tailored thresholds for applicability, as well as GDPR. It applies only to information collected electronically and is unique among other state laws in its concept of regulating the "data stream," *i.e.*, contracts where individuals contract with service providers to offer access to their personal information in exchange for benefits from a business. In addition, it exempts information subject to GLBA. As a threshold matter, an entity must do business in Texas, have over 50 employees, and collect the personal information of over 5,000 individuals. Of those businesses meeting initial thresholds, only businesses that have at least one of: (i) annual gross revenue over $25 million or (ii) 5% of its annual gross revenue derived from the sale or processing of covered personal information. Those meeting the definition of a data processors are required to conduct data use assessments similar to those required under GDPR, among other requirements. Any Texas consumer is entitled to request personal data be deleted, and controllers subject to the law must provide a mechanism for consumers to opt out of processing if conducted for the purposes of advertising or marketing, as well as an appeals process that is conspicuously available.

https://capitol.texas.gov/tlodocs/86R/billtext/pdf/HB04518I.pdf

Text of Bill as legislature (not yet codified): https://lawfilesext.leg.wa.gov/biennium/2023-24/Pdf/Bills/House%20Passed%20Legislature/1155-S.PL.pdf#page=1

Regulatory Updates and Enforcement

Texas Governor Greg Abbott also signed into law an amendment to the state's existing consumer data breach law in Texas in May 2023, modifying the timeframe within which certain notifications must be made to the Texas Attorney General to as soon as practicable but "not later than the 30th day" after determining a breach has occurred, a shorter timeframe than former 60-day window. The amendment also provides that notification shall be made via the specified form on the Attorney General's website and the form itself contains additional details submissions must include. This notification is generally applicable to certain consumer data breaches involving the personal information of over 250 Texas residents. The requirements to notify individual owners of personal private "computerized" data remain unchanged, as do statutory exceptions to such requirements. The amendments will be effective September 1, 2023.

AG Website - https://www.texasattorneygeneral.gov/consumer-protection/data-breach-reporting
Existing Law - https://statutes.capitol.texas.gov/Docs/BC/htm/BC.521.htm#521.053
Amendment - https://capitol.texas.gov/tlodocs/88R/billtext/html/SB00768F.HTM

©CORE-CCO Services, LLC

Not for Redistribution