CORE REGULATORY FORUM

Q1 UPDATE

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Q1 Regulatory Deadlines

- 13F Filings – February 16
- 13G Filings – February 16
- 13H Filings – February 16
- CFTC Exemption – March 1
- Form ADV – March 31

Notable News Headlines

- Goldman Sachs Warns Traders: No "manipulation…" **FT**
- Naked Shorting is Illegal: So How the …" **The Street**
- SEC to probe Reddit-driven stock rallies… **The Hill**

Upcoming Events

- Q2 CORE Regulatory Update Webinar
- Q2 CORE Virtual Roundtable Webinar

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Q1 CORE Regulatory Update Webinar Archive

Q1 Presentation Slides

Regulatory Updates and Enforcement

Introduction

As we reflect on 2020 and look ahead to 2021, it is clear that a lot has changed and much is expected to change at the Securities and Exchange Commission (***SEC***) and in the regulatory environment in general. As expected, when the U.S. presidential administration changes, so does the SEC leadership. Chairman Clayton concluded his tenure in December 2020, and along with him, the Directors of five of the SEC's six major divisions departed, with the sole exception being the Director of the Division of Examinations. The remaining four Commissioners, two Democratic and two Republican, will continue to serve their designated term, but the balance of power will shift when a new Chairman is appointed. Accordingly, we expect a significant change in rulemaking priorities, as is signaled by the number of SEC Commission actions in the weeks and months prior to Chairman Clayton's departure that were split on party lines, as well as potential shifts in examination and enforcement priorities. Expected Chairman appointee Gary Gensler is both a former Chairman of the Commodities Futures Trading Commission, where he was an aggressive regulator and enforcer, and also a former investment banker at Goldman Sachs. Although he has worked and prospered as a direct participant in the financial services industry, as SEC Chairman, he is expected to be a proponent of modernized and effective rules for financial firms that are aggressively enforced. In general, we expect that rulemaking will focus on investor protection and transparency, strengthening public markets, de-emphasis on capital formation through private offerings and modernizing the regulatory landscape, with a bias toward issues that are consistent with a Democratic agenda. Moreover, as market volatility and irregularities have had significant implications for novice investors, seasoned professionals, and the financial industry alike, the response from Democratic leaders is to challenge the status quo.

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Recent SEC Rulemaking

Adopted Rules

Investment Adviser Marketing

In December 2020, the SEC finalized amendments to Rule 206(4)-1, the advertising rule, under the Investment Advisers Act of 1940 (***Advisers Act***). The rule will be effective 60 days after publication in the Federal Register with an 18-month compliance window. The amendment modernizes the 40-year-old rules that govern investment adviser advertisements and payments to solicitors and creates a single rule that replaces the current advertising and cash solicitation rules (Rule 206(4)-1 and Rule 206(4)-3, respectively). In part, the amendments replace the prescriptive nature of the advertising rule with a more principles-based approach. The revised rule replaces certain no-action letters that have historically established guidance with respect to adviser advertisements.

The revised definition of an advertisement now more broadly includes any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser's investment advisory services to prospective clients or private fund investors, or (ii) offers new investment advisory services to current clients or private fund investors. In addition, the definition generally includes any endorsement or testimonial for which an adviser provides cash and non-cash compensation directly or indirectly.

The amended rule includes general prohibitions which are largely consistent with current standards and best practices, as well as specific requirements with respect to performance presentations. Notably, all performance returns, including subsets of a portfolio and targeted returns or projections, must be presented net of fees and expenses with equal prominence to any gross performance provided. Any discussion of prior specific investments must be presented in a fair and balanced manner. Testimonials, endorsements, and ratings must include specific disclosures.

CORE Summary
SEC Adopting Release

Regulatory Updates and Enforcement

Good Faith Determinations of Fair Value

While not directly applicable to private fund managers but rather to registered investment companies (e.g., mutual funds), in December 2020, the Commission adopted new Rule 2a-5 under the Investment Company Act of 1940 (***Investment Company Act***) that establishes an updated regulatory framework for fund valuation practices. The rule requires that fund managers:

- Periodically Assess and Manage Valuation Risks
- Establish and Consistently Apply Fair Value Methodologies
- Test Fair Value Methodologies for Appropriateness and Accuracy
- Oversee and Evaluate any Pricing Services

The rule provides guidance on what constitutes a "readily available" market quotation that would not necessitate fair valuation. In addition, the rule requires segregation of duties so that the portfolio manager does not determine the fair value and specific documentation and reporting to a fund Board regarding the valuation process.

SEC Adopting Release

Harmonization of Private Fund Offerings

In November 2020, the SEC adopted amendments to the Securities Act of 1933 (***Securities Act***) to simplify, harmonize and improve the framework for securities offering exemptions. Recognizing that exemptions from registration under the Securities Act have evolved over time and given the rise of social media and other forms of communication, as well as online trading platforms for unregistered securities, the SEC updated various rules in order to:

- Establish more clearly, in one broadly applicable rule, the ability of issuers to move from one exemption to another;
- Increase the offering limits for Regulation A, Regulation Crowdfunding, and Rule 504 offerings, and revise certain individual investment limits;
- Set clear and consistent rules governing certain offering communications, including permitting certain "test-the-waters" and "demo day" activities; and
- Harmonize certain disclosure and eligibility requirements and bad actor disqualification provisions.

The rulemaking establishes a new integration framework that provides a general principal that looks to the particular facts and circumstances of two or more offerings when determining whether an exemption from registration is available for the particular offering. The new rule provided limited guidance regarding general solicitation; however, it did not provide material changes with respect to general solicitation or general advertising practices other than with respect to test the water and demo days.

SEC Adopting Release

Use of Derivatives by RICs/BDCs

In November 2020, the SEC adopted a new exemptive rule under the Investment Company Act intended to provide a modernized, comprehensive approach to the use of derivatives by mutual funds, exchange traded funds, closed-end funds, and business development companies. The rule is not directly applicable to private funds. The rule permits such registered funds to enter into derivatives such as forwards, futures, swaps, and written options if they comply with certain conditions. In particular, funds utilizing derivatives must adopt a derivative risk management program and comply with a limit on the amount of leverage-related risk based on a relative or absolute value-at-risk "VaR" test. VaR is an estimate of an instrument's or portfolio's potential losses

over a given time horizon at a specified confidence level. Funds utilizing derivatives are subject to Board oversight and reporting and required to report information regarding derivative activities in SEC filings.

SEC Adopting Release

Auditor Independence Rules

In October 2020, the SEC adopted amendments to auditor independence requirements under Regulation S-X that are designed to focus the analysis of independence on relationships and services that may pose threats to an auditor's objectivity and impartiality. The final amendments reflect updates based on recurring fact patterns that the SEC staff has observed in which certain relationships and services triggered technical independence rule violations without necessarily impairing an auditor's objectivity and impartiality. These relationships either triggered non-substantive rule breaches or required potentially time-consuming audit committee review of non-substantive matters, thereby diverting time, attention, and other resources of audit clients, auditors, and audit committees from other investor protection efforts. The amendments revise certain definitions, such as that of "affiliate of the audit client", that previously would have led to technical violations under certain situations where an auditing firm or its affiliates provide services to affiliates of an investment manager or fund. The amendments may ease compliance burdens for private fund managers that have wide-ranging operations, affiliates, and investments where auditing firms or their affiliates provide non-auditing services to affiliates of the private fund managers, such as to portfolio companies, that may have previously resulted in technical violations of the auditor independence rules.

SEC Adopting Release

Proposed Rule Updates

Form 13F Reporting Threshold

In July 2020, the SEC proposed to raise the reporting threshold for Form 13F reports by institutional managers from $100 million to $3.5 billion to reflect the change in size and structure of the U.S. equities market since 1975 when the reporting requirement was first enacted. The proposed changes would have eased the regulatory reporting burden on private funds and other institutional managers, and in fact it is estimated that such a change would have permitted approximately 90% of current 13F filers to stop filing. However, the SEC received hundreds of comments opposing the amendment from investors who routinely utilize information regarding large investors in public company shares as part of their research, as well as public company issuers and others opposing the changes. In general, these comments argued that this change would reduce transparency regarding the shareholders of public companies and be detrimental to public markets. Some commenters suggested more moderate changes to the threshold, e.g., raising it from $100 million to $500 million. Others suggested that rather than permitting institutional managers to stop filing Form 13F, the SEC should require institutional managers to disclose short positions and file more frequently. We do not expect that this proposal will move forward and will monitor for any other proposals to amend Form 13F reporting requirements.

SEC Proposing Release

Finder Exemption from Broker-Dealer Registration

In October 2020, the SEC proposed establishment of a safe harbor under the Securities Exchange Act of 1934 (***Exchange Act***) that would permit finders/solicitors to introduce potential investors to private funds and be compensated without requiring broker-dealer registration. Such finders would be required to make specific disclosures to potential investors, which they would need to reasonably believe to be accredited/qualified investors, regarding their agreement with and compensation from the private fund manager. The proposal would create two classes of finders, Tier I Finders and Tier II Finders, that would be subject to conditions tailored to the

scope of their respective activities. Tier I and Tier II Finders would both be permitted to accept transaction-based compensation under the terms of the proposed exemption.

SEC Proposing Release

Exam Developments

The Office of Compliance Inspections & Examinations (OCIE) was renamed the Division of Examinations in December 2020, elevating its status on par with the other major divisions at the SEC. The Division is led by Director, Pete Driscoll.

- The recently formed "Event & Emerging Risk Examination Team" includes a cross section of people with SEC and industry backgrounds, different skills and expertise and will conduct risk analysis and special projects. We expect this group will likely scrutinize recent market activity, including potentially order flow and shorting irregularities.
- FY 2020 Recap – In fiscal year 2020, which ended September 30, 2020, the SEC Exam Program:
    - Examined 15% of all SEC-registered investment advisers
    - Verified $3.4 trillion in assets in asset verification program
    - Conducted over 300 outreach events
    - Issued 8 Risk Alerts and a report on Cybersecurity and Resiliency Observations
- FY 2021 Priorities – The Exam Program has not yet published its 2021 Exam Priorities memo and we do not expect it any time soon given the changes in agency leadership. However, they continue to prioritize previously stated and several new focus areas based on industry developments:
    - Retail Investors
    - Conflicts of Interest
    - Undisclosed Fees and Expenses
    - Insider Trading & Material Non-Public Information
    - SPACs
    - Alternative Data
    - CLOs/Distressed Credit

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Enforcement Developments

The former Co-Director and Deputy Director of the Division of Enforcement left the SEC in December 2020. The current Acting Director is Melissa Hodgman.

- FY 2020 Recap – In fiscal year 2020, the SEC Enforcement Program:
    - Brought 715 enforcement actions, including 405 standalone actions
    - Named individuals in 56% of enforcement actions involving investment advisers
    - Obtained judgments and orders totaling approximately $4.68 billion in disgorgement and penalties, a record amount
    - Returned more than $600 million to harmed investors
    - Awarded a record $175 million to 39 whistleblowers

Regulatory Updates and Enforcement

- FY 2021 Priorities – SEC enforcement priorities will, in part, follow examination findings and Risk Alerts and are expected to include the following topics:
    - Cybersecurity
    - Compliance Program Deficiencies
    - Supervisory Issues
    - Private Fund Adviser Deficiencies
    - Fees and Expenses
    - Conflicts of Interest
    - Allocation Practices
    - Valuations
    - Pandemic Related Disclosures / Strategy Changes

Enforcement Case Summaries

GPB Capital Holdings (February 4, 2021) – Fraudulent Distributions & Other Violations

The SEC brought fraud charges against this middle-market private equity fund manager and its affiliated placement agent for misleading investors about the source of money used to make its promised 8% annualized distribution payment to investors. Investors were told that such payments were paid exclusively with monies generated from portfolio companies. However, when portfolio company operations were not sufficient to fund the distributions, rather than reduce or suspend distributions, the funds consistently paid an 8% distribution and funded the shortfall by making a portion of the payment with investor funds, or perpetrating a Ponzi-like scheme. The firm further falsified financial statements and overstated the amount of income earned from portfolio companies and created backdated and other fraudulent records to support such claims. The firm also failed to disclose that acquisition fees related to portfolio company transactions were paid to affiliates, instead representing that such payments were made to qualified third parties. The firm was further charged with misappropriating $2.9 million earned by portfolio companies without appropriate Advisory Committee disclosure or consent. The firm was further charged with Custody Rule violations for failure to obtain audits for relevant entities and for failing to register or file requisite reporting for entities that had more than 2,000 equity interest holders, as required under Section 12(g) of the Securities Exchange Act. The firm executed separation and termination agreements with employees who raised concerns regarding the firm's fraudulent distributions which included language prohibiting communications with law enforcement without prior consent of or notification to the firm and took retaliatory action against a third employee who filed a whistleblower complaint. Finally, the firm was cited for inadequate policies and procedures to address conflicts of interest and other issues related to the charges. The case is being litigated.

SEC Release

ICE Data Pricing & Reference Data (December 9, 2020) – Pricing Deficiencies

This global pricing and analytics firm (formerly known as Interactive Data Pricing & Reference Data) is registered with the SEC as an investment adviser and provides independent evaluated pricing for fixed-income securities to clearing firms and custody firms, registered investment companies, pooled investment vehicles and other institutional clients. The pricing service provides independent valuations for the vast majority of the 2.8 million fixed-income securities for which it provides pricing information. For evaluated prices, the firm uses market-based measurements to assess what the holder may receive in an orderly transaction under current market conditions. Evaluated prices are determined by considering various market inputs, including, in approximate order of priority, benchmark yields, reported trades, bids, offers, and two-way markets. However, for approximately 46,000 securities, the firm's applications and models were unable to produce an evaluation and instead the firm provided its clients a single broker-quoted price that it received from a quote provider. According to the firm, it provided a single broker-quoted price when sufficient information, such as

such as cash flows or other security structure or market information, were not available to produce an evaluation. The SEC charged the firm for failing to implement reasonable policies and procedures concerning the provision of single broker-quoted prices, for failing to detect and address unchanged quotes for more than 20 business days or more and failing to assess the reliability or accuracy of quotes received. The firm was ordered to pay an $8 million penalty.

SEC Release

Blue Crest Capital Management (December 9, 2020) – Inadequate Disclosures

This enforcement action against a private fund adviser resulted in a $170 million settlement, the largest against a private fund manager in 2020. The SEC charged the firm with inadequate disclosures, material misstatements, and misleading omissions concerning its transfer of top traders from its flagship client fund to a proprietary fund and the replacement of those traders with an underperforming algorithm. The firm created a leveraged proprietary hedge fund to trade personal capital of its personnel. The firm transferred the best performing traders for its largest strategy to the proprietary fund and hired new traders to trade for the client fund and allocated a substantial amount of the client fund's capital to a semi-systematic algorithmic trading system, with allocations to the system ranging from approximately 17% to 52% of the client fund's total capital. The algorithmic trading system materially underperformed the live traders by an average $25 million per month. The SEC charged the firm with failing to adequately disclose to fund investors or the fund board, and making misstatements and omissions related to, the movement of the traders and related conflicts of interest.

SEC Release

EDG Management Company (October 22, 2020) – Management Fees

This private equity fund manager was charged with failing to reduce its management fee based on write downs to portfolio companies. Fund governing documents provided that during the relevant period, the management fee would be based on the total invested capital contributions, but that the amount should be reduced as a result of certain triggering events, including, but not limited to, write downs of portfolio securities. The case noted that at times during the relevant period, five different portfolio securities held by the fund were subject to write downs under the terms of the LPA but that the manager did not incorporate the effects of the write downs into management fee calculations resulting in an overpayment of management fees by more than $900,000. The firm was ordered to pay $1.02 million in disgorgement plus interest into an account for the benefit of fund investors.

SEC Release

SEC Guidance

SPAC Guidance

Special purpose acquisition companies, known as SPACs, are "blank check" companies that have become popular vehicles for various transactions including transitioning private companies to become publicly-traded companies. The SEC's Division of Corporation Finance, which handles securities registration, issued guidance in December 2020 to sponsors/issuers of SPACs regarding the conflicts and disclosure questions they should consider. In addition, the SEC's Office of Investor Education and Advocacy issued an investor bulletin geared to investors in SPACs. The SEC's interest in SPACs has grown as these vehicles become increasingly popular. Increasing numbers of private fund managers and their related persons are structuring SPACs or considering SPACs as potential investments in such funds or as a part of a private equity funds' portfolio company structure. Accordingly, SEC Examination staff have begun to focus on SPAC investments and relationships during examinations. As firms contemplate SPAC investments and affiliations, they should consider potential conflicts of interest; risks regarding insider trading and material non-public information in relation to SPAC

acquisition targets; whether a SPAC investment is consistent with the fund's governing documents; what disclosure should be made to investors, added to fund offering documents and/or Form ADV regarding the potential SPAC activities; and whether disclosure should be made to, and consent received from, a private fund's limited partner advisory committee.

SEC Guidance – Division of Corporation Finance
SEC Guidance – Office of Investor Education and Advocacy

Other Regulatory Developments

Executive Order – Chinese Military Operations

On November 12, 2020, President Trump signed Executive Order (***EO***) 13959, "Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies", which prohibits certain purchases involving publicly traded securities, securities that are derivative of, or are designed to provide investment exposure to such securities of any Communist Chinese military company. The prohibitions on purchases came into force on January 12, 2021. The EO further requires that US persons divest any securities held in an entity determined to be a Communist Chinese military company within one year of its determination. US persons are authorized for one year to enter into transactions (including purchases and sales) solely to divest securities in the identified military companies. This means that investors have until November 11, 2021 to divest in the 31 entities that were identified as Chinese military companies as of November 12, 2020, when the original Executive Order was issued.

Executive Order
Communist Military Companies List

Anti-Money Laundering Developments

On January 1, 2021, Congress passed the Anti-Money Laundering Act of 2020 ("***AMLA***"), the most comprehensive set of reforms to the anti-money laundering ("***AML***") laws in the United States since the USA PATRIOT Act was passed in 2001. The AMLA is designed to reform and modernize AML and counter-financing of terrorism laws, improve coordination among government and industry stakeholders, and emphasize the importance of risk-based AML/CFT programs. Key reforms include:

- The creation of a national registry that tracks the beneficial ownership information of certain entities;
- Increased AML whistleblower awards and the expansion of whistleblower protections;
- Penalty enhancements for violations of the Bank Secrecy Act ("BSA");
- Codification of the BSA's applicability to virtual currency; and
- Additional mandates to the Treasury Department to combat financing of terrorism, and more.

Like the PATRIOT Act, the AMLA does not include Registered Investment Advisers under the definition of financial institutions subject to the law. However, certain private fund investors may find themselves subject to the new beneficial ownership reporting requirements. In addition, the legislation may likely increase the likelihood that previously proposed AML rules for investment advisers and private funds will move forward.

CORE Summary

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Regulatory Updates and Enforcement

New York Blue Sky Requirements

Beginning December 2, 2020, issuers offering private placements pursuant to a Regulation D exemption under the Securities Act are required to file a Form D through the Electronic Filing Depository (EFD) system within 15 days of first sale to a New York resident and pay the requisite filing fees of $300 for an offering less than $500,000 or $1,200 for an offering greater than $500,000. The new amendment eliminates prior confusion over whether New York notice filings are required under federal securities laws, and replaced a paper-based filing system.

In addition, beginning February 2, 2021, all investment adviser representatives (IARs) of a New York registered investment adviser are required to register with state of New York by submitting a Form U4 and completing requisite securities licenses (e.g., Series 65 or Series 7 and 66). IARs of an SEC-registered investment adviser with a place of business in New York will further be subject to registration. Under Section 203A-3 of the Advisers Act, a IAR is defined as a supervised person of an investment adviser, who (i) has more than five clients who are natural persons; and (ii) more than 10% of whose clients are natural persons. Accordingly, an investment adviser registered with the SEC whose only clients are private funds or institutional investors will not have any supervised persons who are deemed to be IARs.

CORE Summary
New York Regulations

IAR Continuing Education Requirements

In November 2020, the North American Securities Administrators Association (***NASAA***) adopted a new rule that requires that IARs **annually** complete twelve (12) hours of continuing education (***CE***), offered by an Authorized Provider, with the following requirements:

- Six hours of IAR Regulatory and Ethics Content (at least **three** of the six hours covering ethics topics)
- Six hours of IAR Products and Practice

IARs that are also broker representatives and completed requisite CE requirements are able to have a portion of such IAR CE requirements waived. In addition, IARs who have certain professional designations may obtain a waiver, as long as the CE requirements of such organization are completed and the content is approved IAR continuing education content.

To renew registration, or apply for registration, in multiple states, the IAR must be compliant with each individual state CE requirement. Not all of the states have adopted or will adopt the NASAA model rule. To date, Texas has not adopted this requirement per conversations with the Texas State Securities Board registration examination staff.

NASAA Rule

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