CORE REGULATORY FORUM

Q3 UPDATE

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Q3 Regulatory Deadlines

- 13F Filings – August 16
- Form PF Large HF – August 29
- Form 13H – Promptly After Sept 30
- CIMA Private Fund Annual Return & Audited Financial Statement Filing Deadline – September 30

Notable News Headlines

- U.S. SEC says Chinese IPO hopefuls must provide…**Reuters**
- WeWork and Cushman & Wakefield are forming $150M partnership…**WSJ**
- Oil Prices retrench on massive hedge fund sales…**Reuters**

Upcoming Events

- SEC Private Fund Focus Webinar – September 9
- Q4 CORE Virtual Roundtable Webinar

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CORE-CCO

COMPLIANCE: OUTSOURCED RESOURCES AND EXPERTISE

Regulatory Updates and Enforcement

Introduction

Securities and Exchange Commission (***SEC***) Chairman Gensler announced his policy team in July 2021, led by Policy Director, Heather Slavkin Corzo, who was named shortly after Gensler's confirmation in April. Ms. Corzo previously worked as a Director of Capital Markets Policy at the AFL-CIO and as the Head of U.S. Policy at the Principles for Responsible Investment, a group that promotes environmental, social and governance (***ESG***) considerations in investments. Other team members include a new Climate Counsel member, as well as counsel for each of the SEC's policy-making divisions, Investment Management, Corporation Finance, and Trading and Markets. Chairman Gensler's selection of a diverse policy team, with members including veteran SEC policy makers, former labor-union investment officials, ESG enthusiasts, and a former executive for a women-led investment firm focused on impact investing, signal that the SEC will likely pursue progressive policy goals.

Chairman Gensler again testified before Congress in May 2021 in connection with the SEC budget request, during which he highlighted five key trends that would affect the agency's resource needs over the next year:

- **Initial Public Offerings (*IPOs*) and Special Purpose Acquisition Companies (*SPACs*)** – The Chairman noted a "once-in-a-generation" waive of traditional IPOs in 2021 and an unprecedented surge in "blank-check IPOs" or SPACs, which has demanded significant SEC resources and generated significant focus on emerging risks and issues.
- **Private Funds** – He further noted significant growth in the number of private funds, particularly private equity and venture capital funds, with currently more than 18,000 private equity funds and a 58% increase over the past five years, and 1,700 venture capital funds with a >110% increase in that same period.
- **Digital Assets / Cryptocurrency** – The Chair highlighted significant growth in the highly volatile and speculative asset class of crypto tokens with more than $1.6 trillion in valuation in the asset class as of May 2021 compared to $9 billion five years ago.
- **Fintech** – He stated that U.S. capital markets are being shaped by technology, both at traditional firms and fintech startups, highlighting major market events earlier in 2021 largely centered on mobile brokerage apps, as mentioned in his initial Congressional testimony summarized in the Q2 Update.
- **Data Analytics** – Finally, Gensler said that he believes this is only at the very beginning of the economy's growing reliance on the rapidly changing field of data analytics known as deep learning, with capital markets beginning to be impacted from the use of artificial intelligence.

More recently, in public comments, Chairman Gensler highlighted the more than 800 registered investment companies and more than $3 trillion in funds that hold themselves out as investing with an emphasis on sustainability, and the need for more consistent disclosure enabling investors to see what is under the hood of these funds. In the same speech, Gensler acknowledged research highlighting the underrepresentation of women and people of color at the board and senior management levels within asset management firms and fund complexes, noting that SEC staff are considering ways to enhance transparency related to diversity and inclusion practices within the industry.

Recent SEC Rulemaking

As of the date of this publication, there continue to be no final rules approved and no new or amended rules proposed in 2021 that are material to investment advisers or private fund managers. The SEC did, however, recently publish its rulemaking agenda, as summarized below, with key ESG and other rulemaking initiatives expected in October 2021 and subsequent months. The SEC maintains a rulemaking index with the status of rulemaking activities at https://www.sec.gov/rules/rulemaking-index.shtml.

Regulatory Updates and Enforcement

Rulemaking Agenda

In June 2021, Chair Gensler released the SEC's Semi-Annual Regulatory Agenda (***Agenda***). The Agenda, which includes 45 items, up from 32 since the fall release, signals a changing of the guard in SEC leadership and indicates that the new Chairman may be willing to explore unwinding or amending rules recently adopted by the Clayton SEC. Among the topics pertinent to private fund advisers are the following:

Pre-Rule Stage

Exempt Offerings (Updating the Accredited Investor Threshold)
While the definition was updated in August 2020, the thresholds were not increased. The SEC is now considering seeking public comment on "…updating the financial thresholds" to ensure "appropriate access to and enhancing the information available regarding Regulation D offerings, and amendments related to the integration framework for registered and exempt offerings."

Proposed Rule Stage

Environmental, Social, Governance
A continued hot topic, the SEC is considering rule proposals for:

- Climate Change Disclosure – to enhance registrant disclosures regarding issuers' climate-related risks and opportunities (Potentially October 2021)
- Human Capital Management Disclosure – to enhance registrant disclosures regarding human capital management (Potentially October 2021)
- Corporate Board Diversity – to enhance registrant disclosures about the diversity of board members and nominees (Potentially October 2021)
- Investment Adviser/Investment Company Disclosures – to address ESG claims and related disclosures (Potentially April 2022)

Beneficial Ownership in Security-Based Swaps (Potentially April 2022)
Likely a result of the recent Archegos capital scandal, the division is considering recommending that the SEC propose amendments to enhance market transparency, including disclosure related beneficial ownership or interests in security-based swaps.

Custody Rule (Potentially April 2022)
In March 2019, the SEC staff solicited comments on custody issues including digital assets. A potential proposed rule will likely address this issue.

Other Areas

- SPACs – Rulemaking which could include enhanced disclosure requirements (Potentially April 2022)
- Cybersecurity Risk Governance – Rulemaking to enhance issuer disclosures regarding cybersecurity risk governance (Potentially October 2021)
- Form PF – Changes which could include additional disclosures of counterparties, counterparty risk and other items (Potentially November 2021)

Notably absent from the agenda is a potential rule proposal to amend the family office exclusion which had been on earlier agendas.

Shortly after publication of the 2021 agenda, two republican Commissioners issued a joint statement expressing disappointment with the Agenda for "reopening large swathes of work that was just completed without new evidence to warrant reopening" and thereby, in their opinion, "undermin[ing] the Commission's reputation as a steady regulatory hand."

The Agenda outlines the SEC's plan for near- and long-term regulatory action in the coming year, though not all items on the Agenda are always completed from year to year.

SEC Press Release – https://www.sec.gov/news/press-release/2021-99

Regulatory Updates and Enforcement

Environmental and Social Governance Disclosure

As noted in the Q1 Regulatory Update, in March 2021, the SEC requested public input on climate change disclosures, as part of an initiative to adopt standards by which corporate issuers disclose material ESG factors and risks. Comments were due by mid-June and as of the end of July, the SEC had received more than 5000 responses, including hundreds of institutional comment letters from industry participants, trade groups, academic/think tanks, government officials, law firms, and others, as well as thousands of anonymous comments in the form of standardized comment letters. In addition, SEC staff conducted meetings with numerous industry participants and trade group representatives. The views expressed ranged from questioning the SEC's authority to mandate ESG disclosure to imploring the SEC mandate comprehensive, internationally aligned, and specific disclosures in SEC filings. In its comment letter, the CFA Institute provided statistics from a recent survey noting that 85% of respondents reportedly incorporate ESG into their investment decisions, but with many noting a lack of measurement tools available to analyze climate change.

Many commenters expressed concern that the SEC may not have authority to mandate climate disclosures. Some argued that the SEC would need specific statutory authority to do so and that compelling such disclosure would violate the First Amendment. Other commenters highlighted the high compliance costs associated with climate disclosure, particularly for smaller firms. Regardless of such comments, it seems highly likely the SEC will propose disclosure standards in upcoming rulemaking, at least for public companies. Accordingly, comments further focused on the scope and nature of such disclosure.

There was not a consensus on whether disclosure mandates should apply to private companies, with some in favor of subjecting such companies to the same disclosures as public companies but others arguing such mandate was unnecessary or inappropriate. A number of comments supported addressing climate change as part of a broader ESG disclosure framework but with some supporting climate disclosures first.

Commenters responded to the SEC's questions on whether standards should vary by industry, how standards applicable to U.S. registrants should relate to global standards and how the SEC's rules should draw upon frameworks already developed by standard-setting bodies. Many of the most substantial commenters argued in favor of industry-specific standards, drawing on existing frameworks, but expressed mixed views regarding a single global standard.

Some commenters maintained that the SEC should require only qualitative climate disclosures noting the difficulty of quantifying climate data. More argued at least partially in favor of requiring quantitative disclosures, noting that some firms already voluntarily disclose such data and others should be required to do the same. There is more controversy related to scope 3 emissions, or those resulting from activities not owned or controlled by the reporting organization but that the organization indirectly impacts.

Commenters also encouraged the SEC to establish a safe harbor from liability for climate disclosures, as supported by Republican Commissioner Roisman. Some argued that climate disclosures should be furnished to investors, rather than filed with the SEC or provided on a separate disclosure form outside of 10-Ks and 10-Qs, to limit securities law liability for such disclosures. Finally, some commenters, including third-party accounting and audit firms, supported making climate disclosures subject to audit or some other form of assurance, while many others opposed such requirement as impractical.

According to the SEC's Regulatory Agenda, a formal proposal is expected to be issued in October 2021 for public company disclosures, with an additional rulemaking proposal expected in April 2022 related to investment adviser and investment company ESG matters. As the SEC reviews the comments and drafts proposed rulemaking, various international bodies also continue to focus on climate disclosures, including the International Organizations of Securities Commissions and the International Financial Reporting Standards Foundation.

SEC Comment Letters – https://www.sec.gov/comments/climate-disclosure/cll12.htm

Regulatory Updates and Enforcement

Exam Developments

The Director of the SEC's Division of Examinations, Peter Driscoll, announced in July that he would leave the SEC effective August 14, 2021. Daniel Kahl, the Division's Deputy Director since 2018, will be named Acting Director upon Driscoll's departure. Igor Rozenblit, the co-head of the Private Fund Unit (***PFU***) of the Division of Examinations since 2010, also left the agency in June 2021 to launch his own firm, leaving the PFU in the hands of co-head Jennifer Duggins for the near term.

SEC examination staff continue to work and conduct examinations remotely, at least through September 2021 and likely beyond that date. Examination staff in the Fort Worth Regional Office held an outreach program for registrants in July 2021, for which CORE-CCO has provided a summary to clients. In addition to the following risk alert, SEC exam staff issued a risk alert related to the increased use of wrap fee programs, which generally are not applicable to private fund managers.

Principal & Cross Trade Risk Alert

Section 206(3) of the Investment Advisers Act prohibits an investment adviser from directly or indirectly selling any security to a client, or purchasing a security from a client ("principal transactions"), without making disclosure of all material facts to the client in writing before the transaction and obtaining informed consent from the client to such transaction. In 2019, the SEC Exam program issued a risk alert highlighting the most common compliance issues observed in examinations related to principal and agency cross transactions. In July 2021, they issued a follow-up risk alert, summarizing findings from an examination initiative focused specifically on cross trades or principal trades involving fixed income securities. The SEC conducted an exam initiative focused on 20 advisers that engage in cross trades, principal trades, or both, involving fixed income securities. Examiners noted the following deficiencies related to such transactions:

- Policies and procedures were inconsistent with the examined advisers' practices, its disclosures, and/or regulatory requirements;
- Policies and procedures lacked sufficient considerations, guidance or information to enable advisers' personnel to effectively comply or know whether they were complying with the policy;
- Policies and procedures were not effectively tested, such as analyzing trade blotters to identify unreported principal or cross trades;
- Advisers did not identify conflicts of interest related to such cross trades or principal trades, particularly related to pricing or undisclosed markups or fees;
- Advisers did not make appropriate disclosure in Form ADV regarding cross trading activities and conflicts of interest related to such activities.

Exam staff provided the following observations of practices that were effective:

- Compliance Programs – Advisers adopted and enforced policies and procedures that:
    - Incorporate all applicable legal and regulatory requirements;
    - Clearly define and describe covered activities (*e.g.,* what constitutes a principal or cross transaction);
    - Set standards to address such activities (*e.g.,* pricing methodologies, reporting, and approval requirements);
    - Place conditions or restrictions on principal and cross transactions (*e.g.,* transaction rationale, prohibited accounts, best execution requirement, no commissions);
    - Conduct testing for compliance with such policies and procedures.

- Written Disclosures – Advisers that provided full and fair disclosure of all material facts in Form ADV, advisory agreements, fund offering document and/or other communications, including:
  - Nature and extent of principal and cross transactions;
  - Conflicts of interests associated with such transactions;
  - Pricing and costs associated with such transactions;
  - Any remuneration to the adviser as a result of such transactions.

SEC Risk Alert – https://www.sec.gov/files/fixed-income-principal-and-cross-trades-risk-alert.pdf

Enforcement Developments

After Alex Oh, Chairman Gensler's initial pick for Director of the Division of Enforcement, quickly resigned amidst pressure from progressive advocacy groups to appoint a more aggressive prosecutor, in June 2021, the SEC appointed Gurbir S. Grewal as the Director of Enforcement. Grewal previously served as the Attorney General for the State of New Jersey and also served as chief prosecutor in Bergen County, New Jersey. Earlier in his career, Grewal served as Assistant U.S. Attorney for the District of New Jersey, where he oversaw the Economic Crimes Unit, and an Assistant U.S. Attorney in the Criminal Division of the Eastern District of New York (Brooklyn). In his former capacity, Grewal oversaw a number of high-profile securities fraud cases, including a 2015 case involving the hacking of thousands of company news releases enabling a gang of criminals to engage in insider trading.

SEC Enforcement Case Summaries

SPAC Fraud – Trevor R. Milton (July 29, 2021)

The founder, former CEO, and former executive chairman of Nikola Corporation was charged with using social media and other means to disseminate false and misleading information about Nikola products and technology. He founded Nikola in 2015 to manufacture electric and hydrogen powered trucks and build an alternative fuel station infrastructure to support them. Milton raised more than $1 billion in private offerings and helped Nikola go public using a SPAC. During the time when the company was public, Milton used social media posts, TV, and podcast interviews to disseminate misleading information about Nikola's technological advancements, products, in-house capabilities, and commercial achievements, ultimately driving Nikola's stock price up, from which Milton benefitted personally. The SEC's complaint charged Milton with violating the anti-fraud provisions of the Securities Act of 1933 and seeks permanent injunction, an officer and director bar, disgorgement with interest and civil penalties. In addition to the SEC action, Milton is also being charged criminally on two counts of securities fraud and one count of wire fraud. Each criminal count carries a maximum prison term of 20 or 25 years.

SEC Press Release – https://www.sec.gov/news/press-release/2021-141

Form CRS Enforcement Sweep (July 26, 2021)

After a targeted enforcement sweep, the SEC charged 21 investment advisers and 6 broker-dealers for failing to timely file and deliver client relationship summaries (***Form CRS***) to retail clients, despite being twice reminded of the missed deadlines by regulators. The sweep appeared to target firms that indicated on Form ADV Part 1A that the adviser's clients were individuals and high net worth clients but did not file a Form CRS. Wealth management firms servicing retail clients, as well as private fund managers that also have separately managed accounts for retail clients or funds of one for retail investors, are required to file Form CRS. The firms agreed to settle charges each paying civil penalties ranging from $10,000 to $97,000. In 2019 the SEC adopted Form CRS. Firms were expected to begin delivering them to prospective and new retail investors by June 2020 and deliver them to existing retail investor clients by July 2020. While the SEC originally granted some leniency to allow firms to file

the required Form CRS, in December the SEC indicated it would start bringing enforcement actions against violators.

SEC Press Release – https://www.sec.gov/news/press-release/2021-139

SPAC Case – Stable Road Acquisition Company / Momentus, Inc., et al (July 13, 2021)

The SEC brought charges against a special purpose acquisition corporation, its sponsor, its CEO, as well as the proposed merger target and its former CEO. Charges against the acquisition target resulted from misleading claims regarding their technology and the national security risks associated with the firm's former CEO. Acquisition target, Momentus, Inc., is an early-stage space transportation company that is set to merge with Stable Road Acquisition Company, in August 2021. Investors were led to believe that Momentus had tested their propulsion technology in space successfully ahead of the proposed merger. However, the company's only in-space test had, in fact, failed to achieve the primary mission or demonstrate the technology's commercial viability. Along with these misleading claims, the target company and former CEO also failed to accurately represent the extent to which national security concerns involving the CEO undermined Momentus's ability to secure required governmental licenses essential to its operations. The SPAC, its sponsor and CEO were also charged by the SEC for failing to conduct proper due diligence of Momentus for its investors and repeating their misleading claims in public filings. The case noted that although Momentus had provided Stable Road with false information, they are not absolved from penalty due to their obligation to conduct adequate due diligence for investors. The SEC's order finds that Momentus violated scienter-based antifraud provisions of the federal securities laws and that Stable Road violated negligence-based antifraud provisions as well as certain reporting and proxy solicitation provisions. Momentus, Stable Road and its CEO consented to an order to cease and desist from future violations and paid civil penalties of $7 million, $1 million, and $40,000, respectively. The SPAC sponsor consented to the order as well and agreed to forfeit 250,000 founders' shares it would have received following the approved merger. The SEC's litigation against Momentus' former CEO for aiding and abetting fraud charges is currently proceeding with the SEC seeking permanent injunctions, penalties, disgorgement plus prejudgment interest, and an officer-and-director bar.

SEC Press Release – https://www.sec.gov/news/press-release/2021-124

Insider Trading on Dark Web – Apostolos Trovias (July 9, 2021)

The SEC Enforcement Division's Cyber Unit charged a Greek national with perpetrating in a fraudulent scheme to sell "insider trading tips" on the "Dark Web," a part of the internet that requires specialized software to access and is specifically designed to facilitate anonymity by obscuring users' identities, including by hiding users' internet protocol addresses. The anonymity provided by the Dark Web allows users to sell and purchase illegal products and services, including illicit drugs, stolen identities, hacking services, among other illegal activities. In this case, an individual, who goes by "The Bull", engaged in a deceptive scheme to offer an unfair advantage for trading securities in the public markets and sell so-called "insider trading tips" on the Dark Web, from December 2016 to early 2021. He claimed that the information he was selling consisted of pre-release earnings reports of publicly traded companies and order-book date from a securities trading firm that was provided by an employee of the firm. The case notes that such claims were either materially false and misleading and made as part of a scheme to deceive purchasers who wanted to trade on inside information, or if true and sources in fact existed and provided some or all of the tips from actual orderbook data, involved a fraudulent scheme to sell material, nonpublic information that he knew or was reckless in not knowing was obtained in violation of a duty of trust and confidence for a personal benefit to the tippers, including himself. The individual allegedly sold over 100 subscriptions to such information as well as one-off tips to purchasers, many of whom traded on such information. The case was uncovered when information was sold to undercover special agents for the Internal Revenue Service (***IRS***) and Federal Bureau of Investigation (***FBI***). The SEC's complaint charged Trovias with violating the antifraud provisions of the federal securities laws and the U.S. Attorney's Office for the Southern District of New York announced parallel criminal charges.

SEC Press Release – https://www.sec.gov/news/press-release/2021-122

Regulatory Updates and Enforcement

Insider Trading – Eric J. Watson, Oliver-Barret-Lindsay, Gannon Giguiere (July 9, 2021)

The SEC investigated and charged three individuals with insider trading over the 2017 announcement of Long Island Iced Tea Co.'s transition into the crypto blockchain market from its prior position in beverage manufacturing. The company sought to announce its new direction into the blockchain industry and rebranding as The Long Blockchain Company through a press release. Days before the statement was set to be released, a controlling official within the Long Island Iced Tea Co., leaked a draft of the company's planned press statement to a broker and friend using an encrypted messaging application. This individual then proceeded to send the confidential information to his friend, who in turn purchased 35,000 shares of Long Blockchain stock. Once the company's plans were made public, the stock price soared by more than 380%. Within two hours of the announcement, this individual sold his stake in the company for around $160,000 in profits. The broker and friend were each previously charged in pump-and-dump schemes to defraud investors in micro-cap securities. The SEC charged each of the three individuals with violating Section 10(b) and 10b-5 of the Securities Exchange Act of 1934 (***Exchange Act***). The SEC revoked the registration of Long Blockchain's securities in February 2021 after the firm failed to file its financial reports since 2018, noting that the company's supposed pivot to the crypto technology failed to materialize. The company was also kicked off the Nasdaq exchange following volatile swings in its share price.

SEC Press Release – https://www.sec.gov/news/press-release/2021-121

Hedge Fund Front-Running – Sean Wygovsky (July 2, 2021)

A trader for a Canada-based asset management firm and hedge fund adviser used several U.S. held brokerage retail accounts in the names of the trader's family members to engage in a front-running scheme that spanned six years. On over 600 occasions, the trader transacted in family members' accounts ahead of large trades executed on behalf of his employer's fund clients on the same day in the same security, on the same side of the market. Then, typically before the fund accounts completed their executions, the family member accounts would close out their recently established positions, nearly always at a profit. The trader generated approximately $3.6 million in illicit trading profits through such scheme. The SEC charged him with trading on material and nonpublic information and violating his duty to his employer and its clients. The case is ongoing and the SEC is seeking disgorgement of ill-gotten gains and penalties.

SEC Press Release – https://www.sec.gov/news/press-release/2021-118

Insider Trading – Mounir N. Gad and Nathan E. Guido (June 30, 2021)

In this SEC enforcement case, an employee of a California-based bank that assisted private equity firms in financing acquisitions of companies allegedly breached his duty of confidence to the bank's clients. Through his role as a vice president in the bank's sponsor finance group assisting private equity clients, the employee had access to material, nonpublic information about upcoming acquisitions. Between 2015 and 2016, the employees shared confidential information with a friend who then proceeded to buy shares of the target companies, ultimately gaining $51,700 in illegal profits. The friend shared roughly $11,000 of his profits with the employee. The SEC found both individuals guilty of violating the antifraud and tender-offer provisions of the Exchange Act. The employee agreed to pay a civil penalty of $51,700 and the friend agreed to a civil penalty of $40,700. In this case, the employee is also facing criminal charges by the U.S. Attorney's Office for the Northern District of California.

SEC Press Release – https://www.sec.gov/news/press-release/2021-117

FCPA Violations – Amec Foster Wheeler Limited (June 25, 2021)

Amec Foster Wheeler Limited ("Foster Wheeler") agreed to pay more than $43 million to various U.S. and international regulatory bodies for violations of the Foreign Corrupt Practices Act (***FCPA***) and other anti-bribery acts relating to a bribery scheme that took place in Brazil. Foster Wheeler, a company that provided project, engineering, and technical services to energy and industrial markets worldwide, engaged in a scheme to obtain

an oil and gas engineering and design contract from the Brazilian state-owned oil company, Petroleo Brasileiro S.A. (“Petrobras”). According to the SEC enforcement order, from 2012 through 2014, Foster Wheeler's UK subsidiary, Foster Wheeler Energy Limited, made improper payments to Brazilian officials in connection with its efforts to win the contract and establish a business presence in Brazil. The bribes were paid through third party agents, including one agent who failed Foster Wheeler's due diligence process, but was allowed to continue working "unofficially" on the project. According to the order, Foster Wheeler paid approximately $1.1 million in bribes in connection with obtaining the contract. The SEC noted that by continuing to use an agent who presented a significant corruption risk so that Foster Wheeler could expand its business and win a contract in Brazil, the company demonstrated a fundamental flaw in its corporate compliance program. A desire to expand into a new market cannot and should not overwhelm good corporate governance. Ultimately, Foster Wheeler consented to the SEC's cease-and-desist order finding that it violated the anti-bribery, books and records, and internal accounting controls provisions of the FCPA and agreed to pay nearly $23 million in disgorgement and interest, subject to offsets for disgorgement amounts paid in other jurisdictions.

SEC Press Release – https://www.sec.gov/news/press-release/2021-112

Cherry Picking – Ramiro Jose Sugranes and UCB Financial Advisers Inc., et al (June 10, 2021)

The SEC charged Miami-based asset management firms and a director and partial owner of the firms with engaging in a long-term fraudulent trade allocation scheme. The SEC alleged that defendant allocated thousands of profitable trades worth more than $4 million in stocks and options on securities to two preferred accounts held at the UCB entities in the name of the defendants’ parents or close relatives. The case notes that defendant used an average price trading account to purchased stock and options on behalf of numerous client accounts and then allocated those trades to specific account typically later that same date. If the position increased in value during that day, the position was closed out, locking in the same-day profit and allocated to the preferred accounts. If the value of the trades decreased during that day, the position was usually allocated to the accounts of one or more of the firms’ other clients. Accordingly, the defendant allegedly allocated millions of dollars of unprofitable trades to other advisory client accounts with the UCB entities. The SEC seeks disgorgement of the ill-gotten gains in the parents’ accounts and disgorgement of the UCB entities’ ill-gotten gains with interest and penalties. In addition, the SEC seeks to freeze the assets of the defendant and his relatives.

SEC Press Release – https://www.sec.gov/news/press-release/2021-105

Insider Trading Ring – Nathaniel Brown, Benjamin Wylam, et al (June 15, 2021)

In this insider trading case, the SEC used sophisticated market monitoring tools to uncover illegal trades by a Silicon Valley trading ring that resulted in nearly $1.7 million in illicit profits. The parties involved included a revenue recognition manager of Infinera Corporation, who repeatedly tipped the company’s unannounced quarterly earnings to a close friend. The SEC also alleged that the friend, on top of trading on the information himself, tipped another individual who owned him a six-figure gambling debt. That individual in turn tipped three of his friends, each of whom illegally traded on the information as well. Further, one of these friends, who worked as an account manager at public company, Fortinet, Inc. also shared information with the same friends regarding his employer’s upcoming earnings results, and those friends traded on such information. All parties involved were charged with violating Section 10(b) of the Exchange Act and Rule 10b-5 and agreed to pay various amounts in civil penalties. In parallel proceedings, the U.S. Attorney’s Office for the Northern District of California announced related criminal charges against several of these individuals.

SEC Press Release – https://www.sec.gov/news/press-release/2021-103

Cybersecurity Disclosure Controls – First American Financial Corporation (June 14, 2021)

The SEC Enforcement Division’s Cyber Unit settled charges against the First American Financial Corporation, a real estate settlement services company, for their failure to manage and disclose cybersecurity risk and vulnerability. First American was charged with insufficient disclosure practices following discovery of a company

application that exposed over 800 million images from title and escrow over a 13-year period. These leaked images contained a plethora of personal and private client data, including social security numbers and other financial information. Due to failure to manually tag images containing personal information as secure and other flaws in the application, the images were accessible to users that should not have had access and were cached on publicly-available search engines. The firm was publicly notified of this breach in security by a cybersecurity journalist on May 24, 2019, and promptly issued a press statement and furnished a Form 8K on May 28, 2019. Many months prior to releasing these communications, the firm's cybersecurity personnel identified the vulnerability through penetration testing, but did not identify such vulnerability as high risk or promptly remedy the breach. Moreover, the firm's executives were unaware of this discovery by their cybersecurity personnel prior to the May 2019 notification, creating an obvious flaw in their disclosure practices and reporting. First American agreed to pay a $487,616 penalty and is subject to further investigation by the New York State Department of Financial Services.

SEC Press Release – https://www.sec.gov/news/press-release/2021-102

Insider Trading – Chad Calice and Holly Hand (June 7, 2021)

The SEC charged a couple with insider trading involving a pharmaceutical stock, where one of them, a senior project manager for Neuralstem Inc., oversaw a clinical drug trial for an anti-depressant the company was developing. The trial produced negative results, which the company made available by secure server to the company's Chief Science Officer (***CSO***) and an outside biostatistician for validation. The company simultaneously imposed a "quiet period" prohibiting all employees and consultants associated with the trial, from disclosing any information related to the trial data or its results. The project manager had signed the company's confidentiality agreement and annual acknowledgements agreeing to comply with Neuralstem's insider trading policy and ethics code, which prohibited employees aware of material nonpublic information from purchasing or selling its securities, or tipping others, and from disclosing such information to outsiders, unless authorized to do so for a business purpose. Nevertheless, when the project manager learned of the negative results from the CSO, she passed the information onto her partner before a public announcement was made. He also tipped off his uncle who held Neuralstem's shares, and both he and his uncle sold their entire position in the company. After the trial results were made public, Neuralstem's stock dropped approximately 50%. The illegal sharing of confidential information allowed these individuals to avoid losses of nearly $120,000. Both partners were charged with the antifraud provisions of the federal securities laws and agreed to pay penalties totaling approximately $325,000.

SEC Press Release – https://www.sec.gov/news/press-release/2021-94

FINRA Enforcement Case Summary

Systemic Supervisory Failures – Robinhood Financial LLC (June 30, 2021)

As described in our Q2 Update, Robinhood was charged by the SEC in December 2020 for failure to disclose its receipt of payments from principal trading firms for routing customer orders to them and for failing to satisfy its duty to seek best execution. Since then, a $57 million fine, the highest ever levied, has been imposed on Robinhood by FINRA. Robinhood was charged due to multiple failures of its system and policies. Since September 2016, the firm has distributed false and misleading information to customers regarding whether they could place trades on margin, how much cash was in their account, their buying power, the risk of loss they faced in certain options transactions, and whether they would face margin calls. Due to the lack of adequate information, customers lost more than $7 million and Robinhood is required to repay that amount in restitution. Robinhood's business is run almost entirely on algorithms and bots that approve new customer accounts and decide whether they can trade options. Due to these algorithms and bots, the firm approved inexperienced customers for options trading and allowed over 90,000 new accounts to be opened that were flagged for potential fraud or identity theft without any further manual review. Robinhood also failed to supervise their technology that was critical to providing customers with core broker-dealer services, such as accepting and executing customer orders, and to have a reasonably designed business continuity plan. The firm experienced many outages and system failures

during the period from early 2018 to late 2020 that prevented customers from accessing their accounts during a period of historic market volatility. Although by the time of the outages in March 2020 the firm had established a business continuity plan, they did not implement it since it was more applicable to events that impacted their physical location rather than system failures. This created the inability to accept or execute orders placed by customers causing them to lose tens of thousands of dollars. They are required by FINRA to pay more than $5 million in restitution to the affected customers. Among Robinhood's many failures to provide customers with accurate information, their website and application failed to display complete market data information such as the size of a customer's last reported sale or certain consolidated display information that showed the best bid and best offer. Throughout the period of January 2018 to December 2020, tens of thousands of customers filed complaints relating to the false and misleading information provided and their losses caused by outages and system failures. Due to a firm-wide policy, these complaints fell into a category that Robinhood exempted from reporting, even though they were in scope of FINRA's reporting requirements. In addition to the $57 million fine, FINRA imposed sanctions of a censure, restitution of more than $12.5 million plus interest, and an undertaking to retain a third-party consultant in response to these supervisory failures.

FINRA Release – https://www.finra.org/sites/default/files/2021-06/robinhood-financial-awc-063021.pdf

SEC Guidance

Qualified Client Inflation Adjustment

Section 205(a)(1) of the Investment Advisers Act of 1940 prohibits an investment adviser from charging clients performance-based fees. However, the SEC adopted Rule 205-3, which exempts an investment adviser from the prohibition under certain circumstances. Clients that meet particular financial thresholds are deemed to be a "qualified client" for purposes of performance-based compensation to investment advisers. In 2011, section 205(e) was amended to provide that by July 21, 2011, and every five years, thereafter, the SEC shall adjust for the effects of inflation the dollar amount thresholds under section 205(e), rounded to the nearest multiple of $100,000.

In an order dated June 17, 2021, the SEC adopted its proposal to increase the net worth threshold for "qualified clients" from $2.1 million to $2.2 million and increase the dollar amount of the assets under management with an investment adviser requirement from $1 million to $1.1 million. The SEC is making the adjustments pursuant to the five-year inflation adjustment requirement.

The new threshold amounts are effective as of August 16, 2021. Clients that entered into advisory agreements prior to the effective date are "grandfathered" under the prior net worth threshold.

SEC Release – https://www.sec.gov/files/ia-5756.pdf

Investment Adviser Marketing Compliance Guide

The SEC staff has issued a Small Entity Compliance Guide (Guide) with respect to Investment Adviser Marketing that summarizes the amended marketing rule replacing the current advertising and cash solicitation rules, Rule 206(4)-1 and Rule 206(4)-3, under the Investment Advisers Act. The Guide summarizes the definition of "advertisement" which includes both the kinds of communications traditionally covered by the advertising rule and activities previously covered by the cash solicitation rule, including endorsements or testimonials for direct or indirect compensation. The Guide outlines seven general prohibitions on types of activity in advertisements that could be false or misleading. In addition, the Guide indicates that the use of endorsements and testimonials is subject to certain conditions including disclosure, oversight and disqualification requirements and, for arrangements with compensation exceeding $1,000 over the preceding 12 months, a requirement for the adviser to enter into a written agreement with the promoter. The Guide recaps elements of the final rule release (https://www.sec.gov/rules/final/2020/ia-5653.pdf) and notes amendments to Form ADV to disclose investment

adviser marketing practices and specific recordkeeping requirements. The Guide reiterates that prior staff guidance, including no action-letters, regarding the advertising and solicitation rules are being withdrawn. The effective date of the marketing rule is May 4, 2021, and the compliance date is November 4, 2022. Investment advisers may begin complying with the marketing rule any time starting on the effective date but may not pick and choose from the old or the new rule but rather must fully comply.

SEC Guidance – https://www.sec.gov/investment/investment-adviser-marketing

Other Regulatory Developments

Anti-Money Laundering Developments

Potential Revival of FinCEN's Proposed Rule for Investment Advisers

Unlike broker-dealers, investment advisers are currently not required to maintain anti-money laundering (***AML***)/counter-terrorist financing compliance programs under the Bank Secrecy Act (***BSA***), or file Suspicious Activity Reports (***SARs***). In 2015, during President Obama's second term, the Financial Crimes Enforcement Network (***FinCEN***) proposed exactly such a rule for certain investment advisers. Although FinCEN never moved forward, and the Biden Administration has not indicated its intention to revive FinCEN's 2015 proposed rule, it is expected that industry watchdogs will push for implementation under the Biden Administration, and some have already started to do so.

Key provisions of FinCEN's 2015 proposed rule included:

- Certain investment advisers, who manage $100 million or more in regulatory assets, would have been required to develop and implement written AML compliance programs reasonably designed to prevent investment advisers from being used to facilitate money laundering. The program would be risk-based, which was intended to give investment advisers flexibility to create their own programs to meet the risks posed by the specific services they provide.
- The rule delegated FinCEN's authority to examine investment advisers for AML compliance to the SEC.
- The rule did not propose a customer identification program requirement for investment advisers, as FinCEN stated that it anticipated addressing that issue in later rules. (It should be noted that FinCEN's Customer Due Diligence Rule, enacted in 2016, which includes beneficial ownership disclosure and verification requirements, is expected by many to be included as a requirement in any revived version of the proposed 2015 rule).

FinCEN and others in the U.S. (namely, the FBI, via a leaked May 2020 intelligence bulletin) have expressed concerns regarding perceived loopholes in the overall BSA/AML compliance regime and have sought to regulate investment advisers who may be at risk for attempts by money launderers seeking access to the U.S. financial system through entities that are not required to establish AML procedures or file SARs.

Those on the private fund side of the industry have pushed back on certain aspects of the proposed rule, advocating that certain investment vehicles and investment advisers be excluded from the rule, namely private equity funds and their advisers, given the lack of liquidity offered by such funds.

While the timeline is uncertain, investment advisers should prepare for the possibility of having to develop and implement their own AML compliance programs under the Biden Administration. Although many investment advisers already have voluntary AML compliance programs in place, actual regulations would force them to adjust and almost certainly expand their programs.

Currently, even if not required via regulation, there are industry expectations, standards, and best practices that advisers in the private fund industry should keep in mind when considering money laundering risks, some of which include:

- Customer due diligence processes to avoid accepting money from criminals and/or sanctioned individuals or entities.
- Controls related to investors that are politically exposed persons, which may be a risk factor for laundering the proceeds of corruption
- Exposure to jurisdictions that are high risk for transnational organized crime and corruption
- Development and enforcement of policies around investment-related risks, including diligence of foreign assets in both private markets and certain listed securities subject to U.S. sanctions.
- Oversight of outsourced controls, especially as they relate to AML and Know Your Customer responsibilities.
- Conducting training for relevant employees on AML risks, suspicious activities and appropriate steps for conducting due diligence of clients and potential clients.
- Consistency between advisers' AML letters and representations made to counterparties, investors, or other third parties, and actual processes.

Privacy Law Developments

In July 2021, Colorado signed into law the Colorado Privacy Act (***CPA***). The CPA applies to companies (1) conducting business in or producing products or services intentionally targeted to Colorado residents, and (2) who either (a) annually control or process personal data of at least 100,000 Colorado residents or (b) derive revenue or receive a discount on the price of goods or services from the sale of personal data, or control the personal data of 25,000 or more residents.

Like Virginia's privacy law, as summarized in the Q2 Regulatory Update, the CPA does not contain a private right of action, and does not apply to employee or business-to-business data. The CPA will allow residents rights to access, correct, and delete their personal data, or opt-out of the processing of their personal data.

The CPA contains an exemption for data and financial institutions, including private fund managers, covered by the Gramm-Leach-Bliley Act (***GLBA***). The CPA takes effect on July 1, 2023, and companies doing business or marketing in Colorado should begin to reassess their need for compliance based on the new requirements.

Connecticut, Illinois, New York, North Carolina, Rhode Island, and Vermont have closed their legislative sessions without passing their bills. Legislative sessions are currently open the following states which have active bills: Massachusetts, New Jersey, Ohio, Pennsylvania. While most proposed and passed legislation has included some level of exemption for financial institutions covered by GLBA, CORE-CCO will continue to monitor the progress of the proposed legislation for impacts to the private fund industry.

Digital Asset Developments

In recent months, many financial and regulatory authorities have taken a closer look at the crypto markets. As the crypto asset class grows, central banks, securities regulators, and tax revenue departments continue to pose the question of how to approach its regulation. As of August 2021, this asset class adds up to about $1.6 trillion, which is a six-fold increase from just one year ago. Regulators all over the world, from China to the United States, have signaled that the Wild West of crypto assets should prepare for new structure in the near future. A snapshot of pertinent developments is summarized below.

On May 26th, SEC Chair Gary Gensler requested that Congress grant more authority to the SEC to regulate cryptocurrency trading. Gensler stated that many tokens are unregistered securities and are therefore vulnerable to manipulation. He continued, "This asset class is rife with fraud, scams and abuse in certain applications. We need additional congressional authorities to prevent transactions, products and platforms from falling between regulatory cracks." Despite the general lack of regulation in the crypto space, Gensler emphasized that those who use initial coin offerings to raise capital or to engage in securities transactions must comply with the federal

securities laws. Asset managers that invest in these assets may come under securities laws, as well. (See https://www.sec.gov/news/testimony/gensler-2021-05-26)

Outside of the SEC oversight of digital assets, the Biden administration will also aim at collecting more taxes from cryptocurrency assets, granting the IRS more authority to gather information on Americans' assets and transactions. (See https://home.treasury.gov/system/files/266/02.-IRS-FY-2022-CJ.pdf)

Internationally, the Chinese Internet Finance Association and the Chinese Banking Association banned all banks from insuring crypto-based business and allowing clients to deposit or trade cryptocurrencies. Both organizations reacted to the high volatility and ease of manipulation of the crypto markets, hoping to avoid economic destabilization and protect retail investors. (See https://mp.weixin.qq.com/s/Zpl0MWesUp2E8R23fNJf_g)

On a positive note for cryptocurrency, El Salvador will become the first country to make Bitcoin legal tender. The "bitcoin law" will take effect on September 7, 2021, making it possible to pay with Bitcoin in any business in the country. Bitcoin will not replace the U.S. dollar as the country's main currency but will be added as a second option for payment. (See https://www.forbes.com/sites/roberthart/2021/06/25/adults-in-el-salvador-to-get-30-in-bitcoin-as-nation-unveils-details-to-make-crypto-legal-tender/?sh=5d82de85109c)

CORE-CCO recommends that clients specifically address digital assets and cryptocurrency in their Code of Ethics and will help clients draft appropriate language and controls. The SEC has previously stated that Bitcoin and Ethereum are not securities, as they are sufficiently decentralized from the organization that launched them. However, other digital assets that are not decentralized, including those offered in an ICO or similar process by which the organization sponsoring the network financed its operations, more closely resemble an investment in a common enterprise with the expectation of profit (*i.e.,* the "Howey Test"), and therefore would be considered securities. Accordingly, such assets would be subject to Code of Ethics reporting requirements.