

2019 First Quarter Compliance Letter

SEC Exams, Enforcement Actions, Guidance, & More

Issued: April 3, 2019

In Warren Buffet's 2018 [annual shareholder letter](#), he credited much of Berkshire's success to what he described as "The American Tailwind." Buffet wrote: "We are lucky – gloriously lucky – to have that [American Tailwind] force at our back." When reading this section of the letter, I couldn't help but get goosebumps. It's easy to take for granted – this invisible force, this set of circumstances we've been blessed with in this country, that allow a small business to turn a dream into a reality. And there's not a day that goes by that we don't feel tremendously grateful to have been afforded this opportunity.

Now to compliance and our recap of the first quarter happenings. The year began with the government shutdown, which led to an overall quiet quarter from our friends in OCIE and Enforcement. In March, we attended the Investment Adviser Association Conference in Washington, DC. We've summarized the initiatives addressed below.

What are the current SEC rulemakings and regulatory initiatives?

- The **Advertising Rule** remains a "near-term" agenda item to modernize the existing patchwork of guidance.
- The **Custody Rule** is a "long-term" agenda item to address application of complex requirements to challenging asset classes and technology evolvments.
- **Proposed Form CRS** (aka, Customer or Client Relationship Summary) "is happening" according to SEC officials.
- Adapting the **Cash Solicitation Rule** to be applicable to new marketing technologies is a priority item. We highlighted a recent [Robo-Adviser](#) action in our last letter on this subject.
- On the **cyber**-front, the SEC speakers seemed most focused on cloud-based security controls.

What were the SEC examiners up to? SEC staffers reminded the conference audience that the number of examinations is on the rise. Last year 17% of all RIAs were examined and OCIE conducted over 3,000 exams. However, the government shutdown may decrease the total number of exams this year. The scope of the exams will continue to be much narrower and more focused. The SEC uses Form ADV and other publicly available information to assist with examination and risk selection. Cybersecurity controls and use of social media were also mentioned as areas of greater interest. One SEC staffer represented that material changes in assets, use of affiliated service providers, and use of outsourced CCOs could be enough to trigger an exam selection.

Is that all? Below is our [Q1 Chronological List of Key Events](#) and [Upcoming Events & Deadlines](#). For a recap of 2018 events, please visit our published [2018 Year-In-Review for Investment Advisers](#).

Have a wonderful Spring!

-Brad

Q1 Chronological List of Key Events

We left off on January 8, 2019 in our Year-In-Review for Investment Advisers. You can access it [here](#). For those printing this letter, please note that all sources are hyperlinked rather than footnoted.

January 9: [Custody Rule Failure for Lack of Independence](#)

Under the audit approach, in addition to the delivery and registration requirements under the Custody Rule, the auditor must meet the standards of independence described in Rule 2-01(b) and (c) of Regulation S-X. In this instance, the Private fund manager used an accounting firm to help with the funds' financial statements and audit of the funds, which was viewed by the SEC as auditing its own work. The reason the SEC came after the auditor was because the [fund manager](#) was accused of other violations.

January 26: [SEC Returned to Normal Operations After Shutdown](#)

February 13: [OCIE Issues Compliance Alert on Transfer Agent Safeguarding of Funds and Securities](#)

In the only alert issued during the quarter, the exam staff highlight common features of robust safeguarding policies and procedures for transfer agents – but other advisers can make use of the controls too.

February 13: [SEC Charges Former Senior Attorney at Apple with Insider Trading](#)

The SEC complaint alleges that the attorney (who, by the way, was responsible for securities laws compliance at Apple, including compliance with insider trading laws) traded on confidential information ahead of quarterly earnings releases.

February 15: [SEC Charges Cognizant and To Former Executives with FCPA Violations](#)

This case does not involve an investment manager, but we included it as a FCPA awareness for private equity managers. It involves a New Jersey based NASDAQ listed company which allegedly used contractor change requests in an aggregate amount of \$2 million to bribe a construction firm responsible for building Cognizant's new campus in India.

February 27: [SEC Asks Court for Order to Show Cause Why Elon Musk Should Not Be Held in Contempt](#)

Mr. Musk is at risk for not adhering to terms of his SEC settlement, which require him to pre-clear his tweets through counsel. Mark Cuban came to Elon's defense by highlighting the challenge for the industry to obtain interpretive guidance by the SEC on challenging topics. For example, he pointed out the SEC still directs the industry to a [December 23, 1980 SEC Docket](#) for instructions on how to submit no-action and interpretive letters, which includes instructions to send the original letter and seven [hard copy] copies of their request to the Office of Chief Counsel. That same website page states that, The Division of Trading and Markets no-action letters dated on or after January 1, 2002 have to be obtained by submitting a request for a [paper copy](#). We still think Elon should have pre-cleared his tweet. We also think that the SEC should make some updates to its website and outdated processes.

March 5: [BB&T to Return More Than \\$5 Million to Retail Investors and Pay Penalty Relating to Directed Brokerage Arrangements](#)

Adviser settled charges that they made misleading statements in its Forms ADV Part 2A and investment advisory contracts with clients regarding the services and prices offered by its "in-house broker" over other significantly less expensive options. The Adviser failed to disclose the extent of its conflict of interest in its Forms ADV Part 2A or otherwise.

Have questions? Get in touch at Hello@HighCampCompliance.com.

March 6: [Mobile TeleSystems Settles FCPA Violations](#)

This case does not involve an investment manager, but we included as a FCPA awareness for private equity managers. It involves a Russian telecommunications company that is publicly traded on the NYSE, which used a variety of front companies to disguise its payments (e.g., acquisition costs, option payments, purchases of regulatory assets, and charitable donations) to win/bribe/enter the Uzbek market.

March 7: [In the Matter of Ascension Asset Management, LLC](#)

This action involves the failure to make an effort to comply with the Compliance Program Rule, filing inaccurate Form ADVs, and violations of the Custody Rule. But what got our attention was the following: *“Ascension [Adviser] and Gooder [Owner] identified Individual B as Ascension’s CCO in the firm’s Form ADV filed with the Commission on or about February 10, 2011...Moreover, Individual B never agreed to serve as Ascension’s CCO and was unaware that Ascension and Gooder had named him as the firm’s CCO until after he was contacted by the Enforcement Division in 2017.”*

March 11: [SEC Share Class Initiative Returning More than \\$125 Million to Investors](#)

The SEC settled charges with 79 investment advisers relating the receipt of 12b-1 fees for investments without adequate disclosure.

March 15: [In the Matter of Talimco](#)

A conflict of interest existed because the investment adviser advised the seller (CDO) and buyer (private fund) on a mortgage participation asset sale transaction. Pursuant to the CDO terms, the Adviser obtained fictitious bids from market makers to establish advantageous sale price to the fund (in which the principal had a sizable investment and stood to gain on management and performance fees).

March 15: [SEC Staff to Hold Fintech Forum to Discuss Ledger Technology and Digital Assets](#)

The Fintech Forum will be held at the SEC’s Washington, DC headquarters on May 31 and will be open to the public and webcast live via the SEC’s website.

March 18: [SEC Releases Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report](#)

The SEC released their 2020 Congressional Budget Justification, along with their 2018 Annual Performance Report. Notable is their intent to expand the Office of Compliance Inspections and Examinations and dedicate four individuals to “focus on examinations of investment advisors, investment companies, and broker-dealers as these entities are critical market participants interacting with Main Street investors. In particular, staff will be examining for indications of inappropriate or inadequately disclosed fees and expenses, undisclosed conflicts of interest, deceptive sales practices, inappropriate investment recommendations, and elder abuse.”

March 20: [SEC Proposes Offering Reforms for Business Development Companies and Registered Closed-End Funds](#)

The SEC proposed rule amendments that would implement modifications and streamline the registration process to the securities offering and communication processes for affected funds, including BDC’s and other registered closed-end investment companies.

March 28: [Investment Advisor Charged with Stealing Millions from Private Fund](#)



An investment advisor was charged with stealing more than \$3 million from a private fund that it managed and using the money to pay for personal and business expenses. To conceal his theft, he provided false documents and financials to investors and falsely reported in SEC filings that the fund had been audited.

Upcoming Events & Deadlines

- April 15** *Form PF for Large Liquidity Fund Advisers Due*
- April 30** *Employees' Personal Q1 Transaction Reports Due
Annual Update to Form PF Due for Private Fund Advisers
Distribute Updated Form ADV Part 2A to Clients
Deadline for Distribution of Audited Financial Statements to Investors*
- May 31** *FinTech Forum at SEC Headquarters. Focus: Distributed ledger technology & digital assets.*
- June 30** *Deadline to Distribute Audited Financial Statements for Funds of Funds*

About HighCamp Compliance

HighCamp Compliance is a premier, boutique compliance consulting and outsourcing firm helmed by former SEC examiners, CCOs, and proven consulting professionals. HighCamp specializes in regulatory compliance and operational support for SEC-registered alternative and institutional investment managers. The team includes specialists in private equity, real estate, and hedge funds.

Have questions? Get in touch at Hello@HighCampCompliance.com.