

2023 First Quarter Newsletter

Rule Proposals, Risk Alerts, & More for Investment Advisers

The Securities and Exchange Commission ("SEC") remained active this quarter with two new rule proposals that would greatly expand the requirements applicable to investment advisers under the Custody Rule and provide additional notification requirements to clients under applicable privacy regulations. At least to date, the adoption rate of recently proposed rules has not kept pace and remained low. Both proposals are discussed in more detail below.

The regional banking crisis in March was poorly timed for busy financial and operations professionals and continues to impact regional banks despite the FDIC backstop. These bank failures provided another example of the lurking risks associated with investment advisers' reliance upon the operational activities of key service providers.

Off-channel communications continue to be a concern for SEC examinations and enforcement inquiries into books and records, electronic communication policies, and procedures related to the handling of material nonpublic information and other compliance program risks. Interestingly, the SEC's narrative and support for many of the recently proposed rules stem from the need to modernize the rulebook for rapidly changing technologies. Yet there is no movement from the SEC indicating the need to modernize the rulebook for today's usage of electronic communications. As of now, the industry must adhere to business practices that were established before the advent of modern communications platforms.

Artificial intelligence ("AI") has become a significant aspect to manage, with varying opinions on whether it poses a threat to advisers or enhances productivity (or both). Nonetheless, AI and its implementation by staff members will remain relevant to all compliance professionals as they seek to stay on top of risks to their compliance programs.

With that, let's hop into the first quarter's headlines.

First Quarter Headlines

Risk Alert: Observations from Examinations of Newly Registered Advisers

On March 27, the SEC's Division of Examinations ("EXAMS") **issued** a Risk Alert that described its examination process for newly registered investment advisers and some of the Staff's key observations from recent examinations. The Risk Alert noted several common deficiencies relating

to compliance policies and procedures, including insufficient representation of risk areas relevant to the adviser's business, a lack of procedures enforcing the execution of policies, and a failure to have an adequate business continuity plan, including succession planning. Additionally, EXAMS staff observed that some advisers had filings and disclosures that omitted required information or included inaccurate information about the adviser. Finally, the Risk Alert stated that advisers had marketing materials that contained false or misleading information and factual claims that could not be substantiated.

SEC Proposes Enhancements to Regulation S-P ("Reg S-P")

On March 15, the SEC **proposed** amendments to Reg S-P. The proposed amendments would require covered institutions to provide notice to individuals within 30 days if their sensitive information was reasonably likely to have been accessed without authorization. Under the proposal, covered institutions would also be required to adopt written policies and procedures for incident response, among other amendments.

Silicon Valley Bank ("SVB") Failure

On March 10, SVB collapsed following a bank run from depositors over fears regarding the bank's liquidity management. Many advisers were left scrambling to recover both management company and client assets. HighCamp has observed SEC examiners questioning investment advisers regarding their management of SVB's collapse and the steps taken to protect their clients' interests.

SEC Proposes Safeguarding Rule

On February 15, the SEC **proposed** amendments to Rule 206(4)-2 under the Advisers Act (the "Custody Rule"), which would be redesignated as Rule 223-1 (the "Safeguarding Rule") if adopted. The proposed amendments would expand the Custody Rule to cover any client assets that an adviser has custody of, including but not limited to digital assets, real estate, and commodities. Assets would now also include non-traditional line items, such as written options and negative cash. Under the proposal, qualified custodians would be required to have "possession or control" of advisory client assets, with limited exceptions for physical assets and certain privately offered securities. Moreover, advisers relying on the exemption for custodians with physical custody would need to notify a pre-agreed independent public accountant of any purchase, sale, or transfer of beneficial ownership in the assets within one business day, among other changes proposed.

EXAMS Announces 2023 Examination Priorities

As part of its 2023 Examination Priorities **announced** on February 7, EXAMS will pay close attention to whether advisers are properly adhering to the new Marketing Rule and can comply with its substantive requirements, and will continue to focus on private fund managers' calculation and allocation of fees and expenses, use of alternative data, and custody of assets, among other items. EXAMS will also focus on emerging technologies used to support compliance, marketing,

and service investor accounts, with a continuing emphasis on information security and operational resiliency. For more information, please refer to HighCamp's [summary](#) from February.

Division of Investment Management Updates its Marketing Rule FAQ

On January 11, the Division of Investment Management [updated](#) its FAQ to provide additional clarity regarding certain aspects of the new Marketing Rule. Among other things, the FAQ now states that the staff considers displaying the performance of one investment in a private fund to be extracted performance and, therefore, the adviser must display net performance of the investment if it chooses to display gross performance.

Did You Know?

“With more than \$25 trillion of gross assets under management, private funds now have surpassed the size of our entire \$23 trillion commercial banking system.” - Testimony of Chair Gary Gensler before the United States House of Representatives Committee on Financial Services, April 18, 2023.

Q1 Key Enforcement Actions and News

We left off on December 31, 2022 in our [2022 Year In Review Newsletter](#). Please note all sources are hyperlinked rather than footnoted.

SEC Charges Private Fund Auditor with Improper Professional Conduct

On March 29, the SEC [charged](#) Spicer Jeffries and an audit engagement partner with certain failures relating to an adviser's hard-to-value Level 3 assets. The auditor is accused of failing to implement the planned audit approach when potential fraud risks were known, failing to obtain evidence of whether the adviser considered alternative valuation methods, failing to ensure that fair values were determined in accordance with ASC 820, and failing to prepare adequate audit documentation.

Crypto Founder and Eight Celebrities Charged with Fraud and Other Securities Violations

On March 22, the SEC [charged](#) Jake Paul, Lindsay Lohan, and Akon with fraud and other securities violations for allegedly promoting a crypto asset security without disclosing their compensation for doing so. Furthermore, the crypto founder was charged for his role in an unregistered offer and sale and accused of manipulative trading and unlawful promotion of crypto asset securities.

SEC Charges Adviser for Failing to Adopt New Compliance Policies for Clients

On March 13, the SEC **announced** charges against an adviser who failed to properly correct a previously identified deficiency in its compliance policies and procedures. In 2019, the adviser was cited for having a compliance manual primarily focused on broker-dealer activities. However, instead of revising the manual to suit its own business needs, the adviser allegedly adopted another investment adviser's compliance manual without removing references to the other adviser.

Two Brothers Charged with Misappropriating Client Funds and Falsifying Documents

On March 3, two brothers were **charged** by the SEC with fraudulently inflating the fee amounts in clients' advisory agreements and misappropriating clients' funds, among other things. As part of the scheme, the advisers allegedly had clients sign advisory agreements with blank or missing fee amount sections and later filled them in after receiving the signature. They also allegedly altered the stated fee percentage number after receiving a signed copy from the client.

SEC Charges Former PE Firm Consultant and Friend with Insider Trading

On February 23, the SEC **charged** an adviser's consultant (and former CFO of multiple portfolio companies) with insider trading after he allegedly tipped a close friend about an upcoming acquisition the adviser was making of a public company. The consultant, who was frequently retained to help with M&A due diligence, allegedly broke a previously signed NDA, and the friend was able to illegally take advantage of the stock's 54% increase in valuation upon the news of the pending acquisition.

Hedge Fund Charged with Rule 105 Violation

On February 21, an adviser was **charged** with violating Rule 105 when it allegedly bought American Airlines stock in a secondary offering after previously selling the stock short. The adviser tried to use the "bona fide purchase" exception of Rule 105 but did not make the purchase in time and instead bought the offering during trading hours the day the offering was priced. The adviser received its desired allocation the following day despite some personnel raising concerns that the adviser may have failed to meet the conditions of Rule 105 bona fide purchase exemption.

Adviser Charged for Disclosure Failures and Misstated Filings

On February 17, the SEC **charged** The Church of Jesus Christ of Latter-Day Saints and its affiliated investment adviser for allegedly creating separate corporations to file Form 13Fs in an effort to obscure the true portfolio value and hide the Church's wealth. The adviser's scheme allegedly lasted over 20 years and included 12 different entities filing 13Fs hiding over \$37 billion in assets.

NBA Hall of Famer Paul Pierce Charged with Making Misleading Statements About Crypto

On February 17, the SEC **charged** Paul Pierce for allegedly making false statements in his promotion of a crypto asset security on social media. Pierce allegedly failed to disclose his compensation, lied about how much profit he made on the asset's valuation increase, misled followers by sharing a screenshot with an account value much higher than he actually had, and

falsely claimed that he was holding the asset for the long term when he was actually selling it at the same time.

SEC Charges Former BlackRock PM with Undisclosed Conflict of Interest

On January 5, the SEC **announced** charges against a former BlackRock portfolio manager who is accused of using his position and relationships with a film distribution business in which a BlackRock fund had invested to advance his daughter's acting career. Although the investment's valuation fluctuated downward, the portfolio manager continued to recommend further investments in the business and it ultimately became the largest holding in the fund. At the same time, the portfolio manager allegedly sought help from the underlying investment to secure acting roles and industry connections for his daughter.

Q2 Upcoming Key Reporting & Disclosure Deadlines

April 30, 2023	Annual Form PF Due Deliver Audited Financial Statements to Private Fund Investors Deliver Updated Form ADV Part 2A (or summary of material changes) to Investors Q1 2023 Quarterly Transaction Reports Due
May 15, 2023	Form 13F Due for Q1 2023
May 30, 2023	Form PF Due for Large Hedge Fund Advisers for Q1 2023
June 29, 2023	Distribute Audited Financial Statements to Investors in Funds-of-Funds

About HighCamp Compliance

HighCamp is a 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 private equity, real estate, venture capital, hedge fund, and institutional alternative managers. HighCamp is 100-percent employee owned, with a gender-balanced leadership team. The company has locations in New York City (Metro), Los Angeles, Denver, Milwaukee, Delaware and Bozeman.