

# 2023 Third Quarter Newsletter

Rule Proposals, Risk Alerts, & More for Investment Advisers

The SEC remained active this quarter. The headliner was the **adoption** of rules seeking to enhance regulation of private fund advisers, which was swiftly followed by a trade group's **lawsuit** in the US Court of Appeals for the Fifth Circuit that argues that the SEC is overstepping its statutory authority in adopting the rules. With that said, HighCamp is preparing for adoption and we have included a link to our practical guide to the new private fund rules below. Particular nuances aside, the adopted rules were softened and are significantly less restrictive than the proposals.

In other news, the Enforcement Division's Asset Management Group led investigations over more omnibus settlements relating to the custody rule and marketing claims. Large dollar settlements regarding off-channel communications were announced further padding the Division of Enforcement fiscal year end statistics, which ended September 30th. Reporting that Citadel may be willing to **fight** back against SEC's recordkeeping interpretations have some in the industry feeling optimistic that the settlements may be contained before reaching everyone. Our complete listing of what HighCamp believes to be the most noteworthy orders affecting our clients are listed in the Q3 Key Enforcement Actions and News section below.

On the homefront, HighCamp is hiring and looking for bold, ambitious, and team-first personalities to join us. Please pass the message along.

## Third Quarter Headlines

### **Risk Alert: Assessing Risks, Scoping Examinations, and Requesting Documents**

On September 6, the SEC's Division of Examinations ("EXAMS") **released** a Risk Alert providing background on how EXAMS uses a "risk-based approach for both selecting advisers to examine and determining the scope of risk areas to examine." It is a dynamic approach that changes over time depending on market conditions, industry practices, and investor preferences. Additionally,

EXAMS uses technology to analyze industry and firm level data to help identify risks. The risk alert includes a list of commonly asked for documents to assist advisers in preparing for future exams.

## **SEC Increases the Regulation of Private Fund Advisers**

On August 23, 2023, the SEC **adopted** multiple new rules that will impact the operations of both registered and exempt investment advisers to private funds by, among other things, requiring such advisers to document their annual compliance program reviews, requiring and specifying the contents of quarterly reporting provided to private fund investors, restricting advisers to private funds from engaging in certain activities ranging from charging certain fees to seeking indemnification from such funds without disclosure and, in some cases, investor consent, requiring that advisers procure “fairness opinions” from third parties prior to leading secondary transactions, and restricting advisers from granting their investors certain types of preferential treatment (via side letters or otherwise) without disclosing such treatment to all investors in the applicable fund. The SEC also amended Rule 204-2 (the “Books and Records Rule”) and Rule 206(4)-7 (the “Compliance Program Rule”). HighCamp’s practical reference guide on the new private fund rules can be found **here**.

HighCamp maintains a **Key Rulemaking Tracker** with effective dates and pending rule proposals, that is included at the end of this letter.

## **Did You Know?**

“In the last year, we’ve filed approximately 750 enforcement actions and conducted approximately 3,000 examinations of registrants.” - **Testimony** of Chair Gary Gensler before the United States House of Representatives Committee on Financial Services, September 27, 2023.

## **Q3 Key Enforcement Actions and News**

We left off on June 30 in our 2023 **Second Quarter Newsletter**. Please note all sources are hyperlinked rather than footnoted.

### **SEC Charges Adviser with Custody Rule Violation**

On September 28, the SEC **charged** an adviser for allegedly failing to obtain verification by an independent public accountant of all client funds and securities. Agreements between the adviser’s clients and its Clearing Agent allegedly included margin account provisions with language that permitted the Clearing Agent to accept, without inquiry or investigation, any instructions given by the adviser concerning the clients’ accounts. The SEC alleged this provision meant the adviser had authority to obtain possession of client funds and therefore that the adviser was required to follow the custody rule.

### **SEC Charges Adviser for Failing to Disclose Principal Transaction**

On September 28, the SEC **announced** charges against an adviser alleging the firm engaged in principal transactions in one of its private funds when it acquired equity interests in various companies from individuals who were officers and co-owners of the adviser without first disclosing the relationship and obtaining consent.

### **SEC Charges Adviser for Failing to Manage Conflicts of Interest in a Manner Consistent with Its Prior Representations**

On September 28, the SEC **announced** a settlement with an adviser that allegedly failed to follow its previously represented method for handling conflicts regarding client referrals to an affiliated adviser that had common ownership and control. The firm brochure stated the adviser would document why the affiliate adviser was the best choice for the client, but the adviser failed to document this in practice.

### **SEC Charges Adviser for Not Following its Advertised ESG Policy**

On September 25, the SEC **charged** an adviser for allegedly failing to follow its ESG integration policy after marketing itself as ESG-focused and representing that every team uses its proprietary ESG engine to make investment decisions in the portfolio. The adviser represented that through the policy, its analysts were required to include “financially material and reputation relevant ESG aspects into valuation models.” Internal analyses showed inconsistent implementation of the policy, but the adviser nonetheless continued to market it on its website.

### **SEC Charges Adviser for Its Marketing Disclosures**

On September 25, the SEC **announced** a settlement against an adviser that created an index to use in part for advertising its convertible bond strategy. The adviser allegedly failed to disclose that a certain time period used in calculating the index only accounted for convertible bond holdings in its SMA account and omitted cash and other nonconvertible securities held in the SMA. Additionally, the SEC alleged the adviser represented that its index was based upon a *model* portfolio when it was in fact based on convertible bond securities held in a *hypothetical* portfolio.

### **SEC Charges Adviser for Breaching its Duties**

On September 22, the SEC **charged** an adviser for allegedly amending an existing portfolio-monitoring agreement with a portfolio company, without disclosing such amendment to clients and investors. The amended agreement allegedly granted the adviser the right to charge accelerated portfolio monitoring fees if either party terminated the agreement. Additionally, the SEC alleged the adviser transferred an asset owned by its funds to a newly formed private fund without disclosing the conflicts of interest and obtaining investor consent or allowing investors to exit their investment. The transfer locked up investor and client money for an additional 11 years. Finally, the SEC alleged that, due to capital constraints, a fund managed by the adviser made a loan to a newly created fund without collecting interest. The loan was meant to cover deal expenses on a target property that was intended to be purchased by the lending fund but ultimately was purchased by the newly created fund.

### **SEC Charges Two Firms for Violating Whistleblower Protections**

The SEC **announced** a settlement with an adviser after accusing them of violating whistleblower protections due to language in its employee separation agreements. The agreements included representations by the Employee that they had “not filed any complaint or charges against [adviser]... with any state or federal court or local, state or federal agency, based on the events occurring prior to the date on which this Agreement is executed by Employee.” Another adviser was **charged** with requiring new employees to sign employee agreements that prohibited employees from disclosing confidential information to anyone, including regulatory or governmental bodies, in addition to requiring departing employees to sign agreements confirming they had not filed complaints with any governmental agency in order to receive deferred compensation and other benefits.

### **SEC Charges Adviser for Failing to File Form 13F**

On September 13, the SEC **charged** an adviser after the Commission allegedly discovered the adviser had failed to file Form 13F for 21 quarters after first tripping the \$100 million Section 13(f) securities threshold in December 2016. The adviser began filing its required Form 13F filings in April 2022, and then filed all of its 21 previously missing Forms 13F in February 2023.

### **SEC Charges Adviser for Acting as an Unregistered Broker**

On September 12, the SEC **announced** charges against an adviser alleging the adviser received transaction-based compensation for arranging sales to its clients of equity interests in companies that owned certain real estate properties. The adviser received a fee from the sellers for investments made by the adviser’s clients, and in cases where the seller didn’t have an arranged fee, the adviser charged its fund clients 2% of the capital invested. The SEC alleged the adviser served as a broker in these instances.

### **SEC Charges Investment Advisers for Marketing Violations**

The SEC **announced** charges against nine investment advisers that allegedly advertised hypothetical performance to mass audiences on their public websites without having policies and procedures in place to ensure the hypothetical performance was relevant to the likely financial situation and investment objectives of the intended advertisement audience, as is required under the Marketing Rule. Two of the advisers were also charged for failing to maintain copies of their advertisements. Separately, the SEC **announced** charges against an adviser that advertised “annualized” returns as high as 2,700 percent for its crypto strategy but failed to provide disclosure that this was a hypothetical return and that the annualized return was calculated using the strategy’s return from the first three weeks.

### **SEC Charges Five Advisers with Custody Violations**

On September 5, the SEC **charged** five investment advisers with various custody-related failures including failure to have audits performed, failure to deliver audits in a timely manner, and/or failure to ensure client assets were maintained at a qualified custodian. Additionally, some of the firms were charged with failing to properly complete their Form ADV reflecting whether the audits were received. These five charges reflected a similar approach to charges made against **nine** advisers for custody violations in September 2022.

## **SEC Charges Private Equity Real Estate Firm for Failing to Disclose Affiliated Broker Fees**

On September 5, the SEC [announced](#) a settlement against a real estate firm that allegedly used deal teams to cold call individual owners of targeted properties. The deal teams were comprised of the firm's employees, who were compensated partly through a 3% brokerage fee paid by a private fund client on new acquisitions. The SEC alleged fundraising materials for the fund did not disclose that the brokerage fees would be paid to an affiliate of the adviser.

## **Private Equity and Hedge Fund Trade Groups Sue SEC Over Recent Adoption of the New Private Fund Rules**

On September 1, six industry trade groups [sued](#) the SEC alleging the newly [adopted](#) Private Fund Adviser Rules were adopted "without compliance with notice-and-comment requirements, and are otherwise arbitrary, capricious, and abuse of discretion and contrary to law."

## **SEC Charges Adviser with Custody Violations**

On September 1, the SEC [charged](#) an adviser who stated in its Form ADV that it was relying on the Audited Financials Alternative to comply with the Custody Rule but did not actually satisfy the requirements of the exception with respect to any of its private funds. The adviser failed to have the fund financial statements audited for multiple years and therefore also failed to distribute audited financial statements to the investors in the funds.

## **SEC Charges Public Company with Misstating Financials Due to Issues with Commercial Real Estate Loans**

On August 15, a publicly traded bank was [charged](#) with misstating financials when it did not properly reclassify multiple restructured loans that its borrowers refused to pay on until the bank gave concessions on the rate and term. After eventually recording the loans as troubled debt, the bank then failed to follow its policies for the loans' impairment values on the financials. Although this case does not involve an investment adviser, it raises novel valuation reminders with respect to commercial real estate debt investments.

## **SEC Continues to Charge Firms with Widespread Recordkeeping Failures**

On August 8, the SEC [announced](#) charges against ten broker-dealers and one dually registered broker-dealer and investment adviser for failing to meet applicable recordkeeping rules pertaining to electronic communications. The firms were charged almost \$300 million in total as the SEC continues its scrutiny of off-channel communications. On September 29, the SEC [charged](#) another ten firms for widespread and longstanding failures to maintain and preserve electronic communications. The SEC's press release noted that one of the advisers self-reported the compliance failures and therefore received a lighter penalty than the others. The combined penalties in this sweep totaled \$79 million.

## **SEC Charges Fund Administrator with Fraud as it Missed Red Flags**

On August 7, a fund administrator was [charged](#) by the SEC for allegedly following its client's instruction to offset the adviser's trading losses by recognizing an expense reimbursement as a receivable from one of the funds' assets. The administrator allegedly failed to evaluate the

appropriateness of this instruction and ultimately delivered investor statements that materially overstated the value of investors' investments.

## **SEC Charges Multiple Individuals with Insider Trading**

The SEC **announced** charges against a family office executive that allegedly received MNPI from an investment adviser participating in a take-private transaction. The executive allegedly bought shares of the target company ahead of the public announcement in two offshore accounts. The SEC also **charged** an employee at a global law firm that allegedly accessed information regarding, and then traded on the basis of, pending transactions involving the law firm's client. Finally, four individuals were **charged** in connection with an alleged scheme in which an employee at an investment firm and global investment bank used his positions to tip friends regarding upcoming M&A activity. The friends communicated using encrypted messaging platforms and XBOX audio chat.

## **SEC Charges Adviser for Improper Disclosure of Conflicts of Interest Related to a SPAC Transaction**

On July 20, the SEC **charged** an adviser for allegedly causing various private fund clients to participate in PIPE transactions that assisted with financing SPAC business combinations. Personnel of the adviser were members/sponsors of three SPAC entities owning between 20 and 60% of the applicable SPACs. The adviser allegedly failed to disclose this conflict and the benefits received from the transactions.

## Q4 Upcoming Key Reporting & Disclosure Deadlines

<b>October 30, 2023</b>	Q3 2023 Quarterly Transaction Reports Due
<b>November 6, 2023</b>	Preliminary Statements Available for IARD Renewal
<b>November 14, 2023</b>	Form 13F Due for Q3 2023
<b>November 29, 2023</b>	Form PF Due for Large Hedge Fund Advisers for Q3 2023
<b>December 11, 2023</b>	Payment Due for Preliminary IARD Renewal

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## Key Rulemaking Tracker

Rule	Effective Dates	Brief Description
<b>Finalized Rules with Upcoming Compliance and Effective Dates</b>		
<b>Form PF</b>	Dec. 11, 2023	Hedge funds need to report current reporting events within 72 hours of occurrence, and private equity fund advisers need to report private equity reporting events within 60 days of quarter-end
	June 11, 2024	Amended section 4 of Form PF includes questions on GP and LP clawbacks, PE fund investment strategies, fund-level borrowings, events of default, bridge financings to controlled portfolio companies, and geographic breakdown of investments
<b>Form N-PX</b>	July 1, 2024 Compliance date: Aug. 31, 2024 (covers period of July 1, 2023 to June 30, 2024)	Institutional investment managers subject to Section 13(f) reporting requirements need to file an annual Form N-PX showing how they voted proxies relating to certain executive compensation matters
<b>Private Fund Rules</b>	November 13, 2023	All Investment Advisers need to maintain written documentation of their annual compliance program reviews
	September 14, 2024	Private fund advisers with \$1.5 billion or more in private fund assets are restricted from engaging in certain activities, must obtain an independent fairness or valuation opinion prior to completing adviser-led secondaries, and are barred from providing or must disclose certain preferential treatment to investors
	March 14, 2025	Private fund advisers, regardless of AUM, must audit their private funds and deliver quarterly statements to investors containing specified information.  Private fund investors with less than \$1.5 billion in private fund assets are restricted from engaging in certain activities, must obtain an independent fairness or valuation opinion prior to completing adviser-led secondaries, and are barred from providing or must disclose certain preferential treatment to investors

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Rule	Proposed Dates	Brief Description
<b>Proposed Rules</b>		
<b>Regulation S-P</b>	March 15, 2023	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.
<b>Safeguarding Advisory Client Assets</b>	February 15, 2023	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.
<b>Outsourcing by Investment Advisers</b>	October 26, 2022	Among other proposed requirements, advisers would need to be able to document their analyses of the scope of work service providers are performing, each service provider's subcontracting arrangements, and potential risks to the adviser relating to work performed by the provider.
<b>Enhanced ESG Disclosure</b>	May 25, 2022	Under the proposed rule, advisers would have to specify whether they or their private funds pursue ESG "Integration Funds," "ESG-Focused Funds," or "Impact Funds," and disclose certain ESG-related information on Form ADV Part 1A and Part 2A, including methods of analysis, financial industry affiliations, and proxy voting policies, among other things.
<b>Cyber Security</b>	February 9, 2022	Registered advisers would need to adopt policies reasonably designed to address cybersecurity risks, conduct annual reviews of the policies, and report significant cybersecurity incidents and risks to the SEC in new Form ADV-C and Form ADV Part 2A.

## About HighCamp Compliance

**HighCamp** is a boutique compliance consulting and outsourcing firm helmed by former SEC examiners, CCOs and proven consulting professionals. The firm specializes in regulatory compliance and operational support for SEC-registered private equity, real estate, venture capital,





Compliance at a Higher Elevation

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, Dallas, Milwaukee, Delaware and Bozeman.