

2024 First Quarter Newsletter

Rule Proposals, Risk Alerts, & More for Investment Advisers

"But over the past four years, private equity and debt fund assets doubled to almost \$6 trillion, far outpacing the 31% growth rate for public funds. The firms began selling private-credit funds to their core clients—pension funds and endowments that had maxed out on private equity. The fund managers also made inroads with new investors, such as insurance companies and individuals."

- "[Move Aside, Big Banks: Giant Funds Now Rule Wall Street](#)," Wall Street Journal, April 22, 2024

This quarter brought continued focus and initiatives by the SEC targeting private fund managers, including:

- The SEC continued its fight in the US Court of Appeals for the Fifth Circuit against a case brought by registrants arguing that the Commission overstepped its authority by adopting the new Private Fund Adviser rules, all while the industry moves towards implementation of these rules in the latter half of 2024 and early 2025.
- The staff's issuance of a [Marketing Rule FAQ](#) that brought renewed focus to reporting and use of subscription lines of credit in performance return calculations and disclosures.
- Another wave of [Form PF rule amendments](#) were adopted in February to enhance and refine reporting to regulators.

Shortly after quarter-end, the SEC's [off-channel communications](#) net widened to capture a hedge fund manager, resulting in a \$6.5 million settlement.

A complete listing of what HighCamp believes to be the most noteworthy orders affecting our clients are listed in First Quarter Headlines and the Q1 Key Enforcement Actions and News section below.

First Quarter Headlines

Risk Alert: Shortening the Securities Transaction Settlement Cycle

On March 27, the SEC's Division of Examinations ("EXAMS") **released** a Risk Alert advising broker-dealers, clearing agencies, and registered investment advisers on risk areas as a result of the standard settlement cycle for most transactions in U.S. securities shortening to T+1, from T+2. Although the rule mostly effects broker dealers and involves the Exchange Act, there could be significant pressure on registered investment advisers to provide timely trade affirmations, which has been an industry best practice, but the adopting release indicated that despite this best practice only 68% of trades receive same-day affirmations. Accordingly, advisers should be in the closing innings leveraging automation and/or delegating tasks to custodians to adjust to the same day requirements. EXAMS will conduct examinations and do outreach to see how registrants have evaluated the potential impact of the final rules on their business activities, operations and risk assessments, services, and customers, clients, and third parties. Finally, the Risk Alert included a sample document request list to help advisers prepare for what they may expect to see on future examinations.

SEC Adopts Amendments to Enhance Private Fund Reporting

On February 8, the Commission again **adopted** amendments to Form PF. Among the newest changes, large hedge funds (those with NAV over \$500M) will provide enhanced reporting of investment exposure, borrowing and counterparty exposure, currency exposure, country and industry exposure, and certain other risk metrics. Additionally, all advisers will have enhanced reporting on information such as AUM, withdrawal and redemption rights, GAV and NAV, borrowings and types of creditors and beneficial ownership. Advisers reporting complex structures will also see changes in how they report these; generally reporting will require separate reporting for each component fund of a master-feeder arrangement and parallel fund structure. The new Form PF will also require advisers to remove aggregate reporting for large hedge funds. Both the effective and compliance dates for the amendments are March 12, 2025.

Division of Investment Management ("IM") Updated Marketing FAQ

On February 6, IM **updated** its Marketing Rule FAQ with more information on allowable methodologies for calculating gross and net performance. The updated FAQ stated gross and net returns must be calculated using the same methodology over the same period of time. The guidance provided by IM appears intended to eliminate the common industry practice of calculating gross IRR without the impact of leverage (i.e., with capital outflows reflecting the amounts and dates of draws on a subscription line), while calculating net IRR *with* the impact of leverage (i.e., using amounts and dates of capital calls). IM's view is that the timing difference is material and does not allow for equal comparison of gross and net returns. Moving forward, advisers should be sure to calculate both net and gross returns using the same time period and methodology, thereby representing the impact of leverage in the same way for both calculations.

Did You Know?

The U.S. stock market used to settle at T+1 well into the 1920s. Due to increasing transaction volume it was lengthened to T+5 before being shortened to T+3 as a result of the Stock Market Crash of 1987. After the European Commission required equity markets in 29 member countries to move to T+2 settlement, the SEC followed suit in 2017. Now on Memorial Day Weekend in 2024, the U.S. securities settlement will move to T+1.

– Stats given by Chair Gary Gensler in his [remarks](#) before the European Commission.

Q1 Key Enforcement Actions and News

We left off on December 31 in our 2023 [Year in Review Newsletter](#). Please note all sources are hyperlinked rather than footnoted.

SEC Charges Two Advisers for Use of AI Claims in Marketing Material

On March 18, two advisers were [charged](#) for allegedly making claims in their marketing materials that “they were using AI in certain ways when, in fact, they were not.” One adviser stated it used AI and machine learning to analyze its retail clients’ spending and social media data to help inform its investment advice, while the other adviser falsely stated that it incorporated “expert AI driven forecasts” and was the “first regulated AI financial adviser.” Allegedly, neither adviser was able to substantiate its respective statements regarding AI. Other violations noted in the enforcement actions of the two advisers include use of hedge clauses, overstating AUM, inappropriate use of hypothetical performance, improper disclosure around testimonials, and insufficient processes around review and approval of marketing materials.

SEC Charges Adviser for Failing to File Schedule 13D

On March 1, the SEC [announced](#) a settlement against an adviser that failed to file a Schedule 13D within 10 days of holding a public company’s common stock with the intent to change or influence control of the issuer. The adviser initially filed a Schedule 13G but after acquiring additional shares of the issuer and deciding to seek influence or control over the issuer, the adviser failed to file a Schedule 13D until the day it submitted to the issuer, and announced publicly, a proposal to acquire all outstanding shares the adviser did not already hold.

SEC Charges Multiple Individuals with Insider Trading

The SEC [announced](#) a complaint against an individual that allegedly traded in securities after learning about an upcoming M&A through his wife’s role at BP as an M&A manager while she was home working remotely. A pharmaceutical Vice President was [charged](#) with insider trading when he used information gained about an upcoming acquisition to buy stock in the targeted company. Roughly one month after attending meetings between his company and the target, the VP allegedly bought stock in the targeted company and continued to do so until the date of the public announcement when he sold all his stock in the target company. The SEC [announced](#) another complaint against the founder and chairperson of a networks company who allegedly used information he learned through his relationship with another multinational technology company that was considering the acquisition of another firm. The defendant allegedly traded options in the target company in accounts of a close relative and an associate.

SEC Charges Adviser with Rule 105 Violations

On February 21, the SEC **charged** an adviser for purchasing shares of public securities offerings in some client accounts after effecting short sales in the same stocks in other client accounts. The adviser had short sales after a third-party exercised call options that caused the adviser to sell the securities. The adviser then bought the new offering of the securities while in the restricted period under Rule 105.

FinCEN Proposes Rule to Combat Illicit Finance in Investment Adviser Sector

On February 13, FinCEN **proposed** a rule it says will help prevent criminals and foreign adversaries from exploiting the U.S. financial system through investment advisers. The rule would require advisers to apply AML and CFT requirements pursuant to the Bank Secrecy Act. Advisers registered with the SEC, as well as exempt reporting advisers, would be required to implement AML and CFT programs. Further, advisers would be required to file suspicious activity reports and fulfil certain recordkeeping requirements. The proposal would delegate examination authority for the rule to the SEC.

SEC Charges 16 Firms for Recordkeeping Violations

On February 9, the SEC **announced** another set of charges in its continued crackdown on advisers' off-channel communications and recordkeeping failures. The SEC alleged that employees communicated through personal text messages about the business of their employers and sent and received off-channel communications related to recommendations made or proposed to be made. The cumulative fines totaled more than \$81 million.

SEC Adopts Changes to Definition of Dealer/Government Securities Dealer

On February 6, the Commission **adopted** two new rules – Rules 3a5-4 and 3a44-2 of the Securities Exchange Act of 1934 (the Act) – that expand the definitions of a “dealer” and “government securities dealer.” The new rules define the phrase “as a part of a regular business” in Sections 3(a)(5) and 3(a)(44) of the Act to determine if a person is engaged in a “regular pattern of buying and selling securities that has the effect of providing liquidity to other market participants.” Such persons would be required to register as “dealers” or “government securities dealers” under Sections 15 and 15C of the Act, respectively. Among other participants, certain hedge funds will have to register as dealers unless an exemption applies.

SEC Charges Principal for Failing to Disclose Multiple Conflicts of Interest

On February 2, the SEC **announced** charges against a principal of an adviser for failing to disclose ownership conflicts in another adviser and past criminal charges. The principal allegedly knew the adviser (adviser “A”) needed liquidity for investor redemptions and raised money for a new adviser (adviser “B”). The principal then allegedly directed adviser B to invest a substantial portion of its client’s assets into funds and portfolio companies of adviser A but failed to disclose the conflict of interest to investors of either adviser. Additionally, multiple individuals involved allegedly had past criminal convictions, Commission consent orders, and regulatory consent orders that were not disclosed.

SEC Charges Individual for Role in Miscalculating Pension Fund's Performance

On January 22, the SEC **charged** an individual for her role in miscalculating a crucial performance statistic as an investment adviser and consultant to a Pennsylvania pension fund. The miscalculation relates to the "risk share," which requires employees to contribute more capital to the pension if a certain return hurdle is not met. The pension and state treasurer reached out multiple times to get an explanation on reporting discrepancies but the individual allegedly continued to make misstatements and omit facts even after discovering the error.

SEC Charges Foreign Investment Firm Consultant with Insider Trading

On January 22, the SEC **charged** a consultant with insider trading after he allegedly used information he gained from his client regarding a pending SPAC transaction to buy shares and warrants ahead of public news on the potential merger.

SEC Charges JPM Securities for Whistleblower Violations

On January 16, the SEC **announced** a settlement with JPM Securities over its alleged practice of having certain clients sign confidentiality agreements that impeded the client from disclosing violations of federal securities laws to the Commission except in response to a direct inquiry.

Q2 Key Reporting & Disclosure Deadlines

- 4/29/24** Annual Form PF Filing Due; Form ADV Part 2A Delivery; Distribute Private Fund Audited Financial Statements
- 4/30/24** Quarterly Transaction Reports Due
- 5/15/24** Quarterly Form 13F Due
- 5/30/24** Quarterly Form PF for Large Hedge Fund Advisers Due; Quarterly Form PF Event Reporting

Key Rulemaking Tracker

HighCamp maintains a Key Rulemaking Tracker with effective dates and pending rule proposals on its [website](#).

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, 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 and Bozeman.