HIGHCAMP

Compliance at a Higher Elevation

# 2024 Second Quarter Newsletter

## Rule Proposals, Risk Alerts, & More for Investment Advisers

This quarter, the industry saw significant legal developments. Particularly noteworthy, the US Court of Appeals for the Fifth Circuit decided to vacate the SEC's recently enacted amendments to rules governing private funds. The SEC's forthcoming response remains uncertain, prompting many advisors to halt their ongoing preparations. At the end of its term, the Supreme Court **issued rulings in two prominent cases** that limit the powers of Federal Agencies. In SEC vs Jarkesy, the Court ruled that defendants facing securities fraud allegations from the SEC have a constitutional right to a jury trial in cases involving civil penalties. The recent dismantling of the Chevron doctrine, shifting power from administrative agencies to the judiciary, highlights the Court's commitment to resolving statutory ambiguities through judicial review rather than deferring to federal agencies.

A comprehensive compilation of what HighCamp considers the most significant rulings impacting our clients can be found in Second Quarter Headlines and the Q2 Key Enforcement Actions and News section below.

# Second Quarter Headlines

**US Court of Appeals for the Firth Circuit Vacates SEC's Private Fund Rule Amendments**
On June 5, the US Court of Appeals for the Fifth Circuit **vacated the SEC's Private Fund Rule Amendments** that were adopted in August 2023. Judge Kurt D. Engelhardt stated that the SEC "exceeded its statutory authority" when creating the rules. It remains unclear what the next steps will be for the SEC and whether it will try to pass similar amendments in the future. For now, many advisers can take a sigh of relief and hold off on some of the preferential treatment requirements and preparing the previously required quarterly statements, although some investors may request certain aspects of the rule in their negotiations with advisers.

**SEC Adopts Amendments to Regulation S-P**
On May 16, the Commission **adopted** amendments to Regulation S-P aimed at expanding protections available to customers of institutional securities market participants. The new amendments establish a minimum standard for data breach notifications, requiring the

implementation of an incident response program "reasonably designed to detect, respond to, and recover from unauthorized access to or use of customer information." If a breach were to happen, advisers need to assess the nature and scope of the breach and identify the customers with information that was accessed. Advisers are required to contain and control the incident and subsequently notify affected individuals. Notably, the amended rule contains an exception to the notification requirements in the case that the sensitive information "has not been, and is not reasonably likely to be, used in a manner that would result in substantial harm or inconvenience."

**SEC and FinCEN Propose Joint Consumer Identification Program ("CIP") Requirements**

On May 13, the SEC and FinCEN jointly **proposed** a rule that would require SEC advisers to establish, document, and maintain a written CIP. The proposed requirements are largely similar to requirements already in place for other financial institutions, including broker-dealers. Among other things, the CIP would need to contain procedures for identifying and verifying customer identities, maintaining certain records, and determining whether a customer appears on certain government lists. For private funds, the adviser would treat the fund as its customer and therefore the investors into the fund would not fall under this proposal. The new rule follows FinCEN's AML proposal for advisers released in February. FinCEN has proposed delegating examination and enforcement responsibilities of the rule to the SEC.

**Risk Alert: Initial Observations Regarding Advisers Act Marketing Rule Compliance**

On April 17, the SEC's Division of Examinations ("EXAMS") **released** a Risk Alert advising registered investment advisers on observations it has made from initial examinations with the new Marketing Rule in effect. Notable observations include informal, unwritten policies and procedures that did not cover the preservation and maintenance of advertisements and related documents (i.e., copies of surveys or questionnaires used in third-party ratings). EXAMS also noted that advisers did not properly check the marketing activities boxes in Item 5.L of Form ADV. Finally, the Risk Alert provided numerous examples where EXAMS found advisers violating the seven general prohibitions under the Marketing Rule.

# Did You Know?

"Private credit has been growing exceptionally… The entire commercial banking sector in the U.S. has only $2.8 trillion in commercial and industrial loans. The global private credit market has about $1.6 trillion, predominately in the U.S."
*– Stats given by Chair Gary Gensler in his **remarks** at the 2024 Conference on Emerging Trends in Asset Management.*

The SEC's funding was kept flat for FY2024 which caused the SEC to reduce spending in some desired areas. An example includes the ability to update and improve the Division of Enforcement's ("Enforcement") document management and review systems – tools it deems critical to review the massive document productions during its investigations and litigations. Chair

Gensler stated that the data processing of Enforcement has grown 20 precent YoY for the last three years. Gensler further stated that the SEC has had to cut back investments in Enforcement and EXAMS' analytics capabilities.
– ***Testimony*** *from Chair Gary Gensler Before the Subcommittee on Financial Services and General Government*

# Q2 Key Enforcement Actions and News

We left off on March 31 in our 2024 **Year in Review Newsletter**. Please note all sources are hyperlinked rather than footnoted.

**SEC Charges Multiple Individuals with Insider Trading**
The SEC **announced** a settlement against the former chairman of a public company after he allegedly told close friends about his company's upcoming acquisition of another company. An individual was **charged** with insider trading after learning of MNPI through a personal conversation about career advice with a friend that was a senior executive at a public company that was about to be acquired. The executive was discussing long term career plans and how he may need new work after the acquisition when the charged individual made trades based on this and obtained profits over $50,000.

**SEC Charges Private Fund Adviser with Marketing Rule Violations**
On June 14, the SEC **charged** an adviser for misleading performance advertising when it advertised to perspective fund investors. The adviser allegedly presented returns of a single investor that did not constitute the fund's actual performance and failed to disclose that the single investor's performance differed substantially. The single investor had been invested in the fund since its inception and had investments in a few IPOs that were successful and that numerous other investors were ineligible due to separate FINRA rules.

**SEC Charges Adviser for Failing to Disclose Partnership with Activist Short Selling Publishers**
On June 11, the SEC **announced** a settlement with an adviser accused of inadequately disclosing its investment strategy. The adviser's Private Placement Memorandum (PPM) outlined its short strategy but omitted the involvement with activist short publishers, including formal agreements and payments to them. These payments were in exchange for receiving advance copies of the publishers' reports before public release. Additionally, the adviser allegedly violated books and records requirements by inaccurately recording these payments as fees to a third-party intermediary for services that were not rendered.

**SEC Charges Adviser with Making False and Misleading Statements**
On May 29, the SEC **announced** charges against an adviser and its cofounder for making materially false and misleading statements to investors about the exposures of three private funds it advised. The cofounder is alleged to have modified holdings and exposure data that was given to him by other team members and included in investor communications. The communications were distributed without further compliance review or independent verification of their accuracy.

Additionally, the adviser allegedly failed to disclose that a second cofounder was trading external capital through his own undisclosed fund in China.

**SEC Charges Firm with Rule 105 Violations**
On May 20, the SEC **charged** filed charges against an unregistered firm that bought shares of public securities offerings after conducting short sales in the same stocks during Rule 105's restricted period. The firm engaged in this practice twenty-three times, resulting in gains of nearly $600,000 over a span of more than three years.

**SEC Charges Individual for Role in Fraudulent Billing Harming REITs**
On May 17, an individual was **charged** for his alleged actions assisting certain vendors controlled by friends and family in either overcharging the adviser for services or billing the adviser for services never actually performed. The individual was responsible in the hiring and approving payments to certain contractors. After the adviser paid the fraudulent invoices, the charged individual went on to receive kickbacks from the vendors.

**SEC Charges Adviser for Breaching Fiduciary Duty**
On May 14, the SEC **announced** a settlement with an adviser and its founder that managed a private fund and SMAs that invested in films. The adviser allegedly failed to disclose a conflict of interest that the founder personally received executive producer compensation - typically three percent of the amount of financing he was able to deliver through the clients for the respective film. Additionally, the SEC alleged that the adviser paid one investor's redemption request in full while simultaneously leaving other submitted redemption requests outstanding and unpaid.

**SEC Charges Adviser with Making False Claims on its Form ADV Filing**
On May 7, the SEC **charged** an adviser that registered with the Commission although it allegedly failed to meet the required RAUM threshold. The adviser allegedly did not manage any client assets and instead facilitated the transfer of client money held in its custody to certain private investment vehicles designated by the client. Furthermore, the adviser allegedly failed to comply with the required custody rule after incorrectly registering as an investment adviser.

**SEC Charges Adviser Over Joint Legal Fee Arrangement with its Client**
On April 29, the SEC **announced** charges against an adviser that incurred legal expenses, from the same counsel, at both the adviser and client level as a result of a regulatory inquiry and separate private lawsuits. Without the necessary prior approval, the adviser arranged for the client to pay the entire legal expenses initially. After eventually paying some of the expenses it accrued, the adviser then had counsel allocate its expenses and the adviser paid its portion with interest. The SEC alleged the adviser benefited from deferring payment of its legal expenses for multiple years and that the allocation ultimately chosen was more favorable to the adviser than the final allocation the adviser's insurance carrier calculated.

**SEC Charges Investment Adviser for Alleged "Pay-to-Play" Violations**
On April 15, the SEC **charged** an adviser after a covered associate made a campaign contribution to a candidate for elected office that had influence in selecting investment advisers for a state

investment board. The adviser already had the state investment board as an investor in funds it advised prior to the contribution, and it continued to receive compensation for its advisory services after the contribution was made.

**SEC Wins Jury Verdict for Trial of Novel Shadow Trading Case**
On April 5, a civil jury **sided** with the SEC in an insider trading case concerned with "shadow trading." The SEC's charges in the case alleged the individual, who was employed by a publicly traded biopharmaceutical company, bought call options in a similar publicly traded company seven minutes after receiving an email from his CEO about an imminent deal in which his company would be purchased by a different large publicly traded company. The SEC argued it is a violation of federal securities laws to trade securities of one company based upon MNPI about a separate company. The SEC originally filed its civil complaint in August 2021.

**SEC Charges Hedge Fund for Off Channel Communication Violations**
On April 3, the SEC **announced** a settlement with a hedge fund over its employees' use of off-channel communications and failure to maintain required books and records. Multiple senior officers were accused of sending thousands of off-channel communications concerning securities advice, with some individuals having settings configured to automatically delete messages after 30 days. This enforcement is notable due to the fact this is the first electronic communications case involving an RIA without an affiliated broker-dealer. The adviser was also charged for employees failing to adhere to provisions in its code of ethics requiring pre-clearance for all securities transactions.

# Q3 Key Reporting & Disclosure Deadlines

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| **7/30/24** | Quarterly Transaction Reports Due |
| **8/14/24** | Quarterly Form 13F Due |
| **8/29/24** | Quarterly Form PF for Large Hedge Fund Advisers Due; Quarterly Form PF Event Reporting |
| **8/31/24** | Form N-PX Due |

# 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.