

SEC Developments: Implications, Issues and Solutions

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Presenters

Kit Addleman – Partner, Haynes and Boone, LLP

Kit Addleman leads the securities enforcement defense practice at Haynes and Boone. Kit defends companies, executives, and directors against charges of civil and criminal misconduct, particularly investigations and litigation by the SEC and DOJ. Representative experiences include defending allegations of insider trading, private fund and advisor fraud, and compliance or disclosure violations. She also counsels investment advisors and private funds, among others, concerning compliance obligations and examinations. Prior to joining Haynes and Boone, Kit was the regional director of the Atlanta Regional Office of the SEC. She led the enforcement, examination and bankruptcy programs for the SEC in five Southeastern states. Including her more than 20 years of experience with the SEC in four regional offices, Kit has practiced in the securities industry for more than 30 years.

Kimberly Garber – Founder/Chief Executive Officer, CORE-CCO

As Founding Principal of CORE-CCO, a specialty compliance firm providing outsourced compliance resources and expertise to private fund managers and select institutional managers, Ms. Garber has nearly 30 years regulatory and compliance experience. She is the former head of the SEC Fort Worth Regional Office Examination Program and is an expert in federal securities laws and regulatory developments. Ms. Garber is also an expert in private fund compliance issues, providing compliance services to private equity funds, hedge funds, real estate funds, oil and gas and other alternative fund managers. As an experienced in-house compliance officer and regulator, she has extensive regulatory contacts and insights into regulatory and compliance processes and challenges.

Agenda

- **Recent SEC Developments & Updates**
- **Expected Biden/Harris Regulatory Environment**
- **Implications, Issues & Solutions**
- **Summary**

Emerging Issue: Progressives' response to recent market volatility challenges status quo

Departures with Change of Administration

Chairman

- Jay Clayton and Chief of Staff

Division of Examination

- Pete Driscoll (Director) – Only Director Not to Leave

Division of Enforcement

- Stephanie Avakian (Co-Director) – Gone
- Marc Berger (Acting Director / Deputy Director) – Gone

Division of Investment Management

- Dalia Blass (Director) – Gone
- Paul Cellupica (Deputy Director / Chief Counsel) – Gone

Division of Corporation Finance

- Bill Hinman (Director) – Gone
- Shelley Parratt (Acting Director / Deputy Director) – Gone

Division of Trading and Markets

- Brett Redfearn (Director) – Gone

Division of Economic and Risk Analysis

- S.P. Kothari (Director / Chief Economist) – Gone

Remaining Commissioners

5-Year Staggered Terms

May serve up to 18 months after expiration

Allison Herren Lee
(Acting Chair)

- Democrat
- Appointed 2019
- Acting Chair 2021
- Term Expires 2022

Caroline
Crenshaw

- Democrat
- Appointed 2020
- Term Expires 2024

Elad Roisman

- Republican
- Appointed 2018
- Term Expires 2023

Hester Peirce

- Republican
- Appointed 2018
- Term Expires 2025

Recent Final Rulemaking

Potential Impact of Biden Freeze?

Left
Vote

Investment Adviser Marketing Rule

- Adopted 12/22/20 / Effective 60 Days after Posted in Federal Register



Disclosure of Payments by Resource Extraction Issuers

- Adopted 12/16/20 / Effective 3/16/21



Delegation of Authority to Enforcement Division Director

- Adopted 12/10/20 / Effective 12/29/20

Market Data Infrastructure

- Adopted 12/9/20 / Effective 60 Days after Posted in Federal Register



Good Faith Determinations of Fair Value

- Adopted 12/3/20 / Effective 3/8/21

Regulation S-K / Updates to Financial Disclosures & MDA

- Adopted 11/19/20 / Effective 2/10/21



Recent Final Rulemaking

Potential Impact of Biden Freeze?

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Vote

Harmonization of Private Offerings

• Adopted 11/2/20 / Effective 3/15/21



Use of Derivatives by RICs/BDCs

• Adopted 10/28/20 / Effective 2/19/21



Customer Margin Rules for Security Futures

• Adopted 10/22/20 / Effective 12/24/20

Auditor Independence Rules

• Adopted 10/16/20 / Effective 6/9/21



Fund of Funds Arrangements

• Adopted 10/7/20 / Effective 1/9/21

Accredited Investor Definition

• Adopted 8/26/20 / Effective 12/8/20



Recent Proposed Rules

Expectations for Progress or Final Proposal

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Vote

Finders Exemption from B/D Registration

- Proposed 10/7/20 / *"I'm not dead yet..."*
- Statement by now acting Chair Allison Herren Lee in opposition



13F Reporting Threshold for Institutional Managers

- Proposed 7/10/20 / Presumed dead
- Significant negative comments received



FY2021 Enforcement Developments

56% of enforcement actions involving IAs in FY20 named individuals

- Share Class Selection Disclosure Initiative Continues
 - Voya Financial Advisors, Inc. (Dec. 21, 2020)
 - Cap Wealth Advisors (Dec. 15, 2020)
- Policies and Procedures Failures
 - TSP Capital Management (May 22, 2020)
 - ICE Data Pricing & Reference Data LLC (Dec. 9, 2020)
 - Cannell Capital and others in 2020
- Disclosures regarding trading strategy and algorithm use
 - BlueCrest Capital Management (Dec. 8, 2020)

More FY2021 Enforcement Developments

- Private Fund Management Fees
 - EDG Management Company (Oct. 22, 2020)
- Exchange-Traded Products Initiative Actions (Nov. 13, 2020)
 - American Portfolios Financial Services/American Portfolios Advisors Inc., Benjamin F. Edwards & Company Inc., Royal Alliance Associates Inc., Securities America Advisors Inc., and Summit Financial Group Inc.
 - OCIE comment on the cases
- Undisclosed principal trades and violative cross trades
 - Palmer Square Capital Management (Sept. 21, 2020)
- Undisclosed Performance Fees and custody rule violations
 - Finser International (Sept. 28, 2020)
- Allocation “Cherry Picking” violations
 - TH Wealth Management, LLC (Dec. 18, 2020)

Examination Developments & Updates

Office of Compliance Inspections & Examinations (“OCIE”) renamed Division of Examinations

- Recent formation of “Event & Emerging Risk Examination Team” – Cross section of people with SEC and industry backgrounds, different skills and expertise to conduct risk analysis and special projects
- FY 2020 Exam Statistics:
 - Examinations of 15% of all SEC-registered investment advisers
 - Continuation of asset verification program – Verified 4.8 million investor accounts totaling \$3.4 trillion in assets
 - 8 Risk Alerts + Report on Cybersecurity and Resiliency Observations
 - Numerous outreach programs including virtual Compliance Outreach Program in November 2020 – https://www.sec.gov/video/webcast-archive-player.shtml?document_id=copns111920
 - **Significant focus on deficient compliance practices**

COVID Impact on Enforcement Activities

- Staff has been working remotely since March 2020 with expected continuation through the end of June 2021
- Enforcement processes all virtual and remote, including testimony, interviews and meetings
- Difficulties with virtual processes
- Staff leniency growing thinner

COVID-Related Enforcement Matters

Offering Fraud and Company Disclosures

- Cheesecake Factory, Inc. (Dec. 4, 2020)
- Applied Biosciences Corp. (May 14, 2020)
- Turbo Global Partners (May 14, 2020)

COVID Impact on Examination Activities

- Exam staff working remotely since March 2020 with mandatory telework at least through the end of June 2021
- All examinations conducted remotely – Connectivity & distance problems
- Extensions granted to document production
- Flexibility around scheduling phone interviews
- Additional time to respond to deficiency letters (60 vs. 30 days)

Exam focus area developments due to COVID:

- August 12, 2020 Risk Alert
- Impact on firms from remote work, adequacy of BCP and transition planning
- Firms with significant COVID exposures based in industry, sector, etc.
- Valuation adjustments and considerations resulting from COVID
- Materially misleading disclosures regarding use of PPP funds

Expected Biden/Harris Regulatory Environment

Expected SEC Chairman: Gary Gensler

Author:

*The Great Mutual
Fund Trap*

*Actively managed
mutual funds with
higher fees generally
perform worse than
“passive” low-fee
index funds*

- MIT Professor
- Former Chairman of the CFTC (2009-2014)
- Former Senior Advisor to Sen. Paul Sarbanes during Sarbanes-Oxley Act
- Former Undersecretary for Domestic Finance
- Former US Treasury Assistant Secretary for Financial Institutions
- Former Investment Banker at Goldman Sachs

Gensler is “not a crusader who hates financial firms. He just believes that they need up-to-date guardrails and rules – and that those need to be enforced.”

“Markets work best when there’s a cop on the beat.”

--Gensler

Expected Policy Focus and Regulatory Environment

General Themes

- Investor Protection & Transparency
- Strengthening Public Markets
- Reducing Focus on Capital Formation through Private Offerings
- Modernization of Regulatory Landscape
- Regulation Consistent with Democratic Agenda

Potential Policy Focus and Regulatory Environment

Specific Themes

- ESG
- AML/KYC
- Conflict Disclosure
- Reg BI Revisited
- Market Infrastructure
- Compensation Practices
- Crypto/Digital Assets
- Custody
- Activist Disclosures

Potential Enforcement Focus

Additional Enforcement Resources Anticipated for 2021

- Exam priorities and exam findings will be priorities along with topics in OCIE risk alerts
 - Cybersecurity, compliance program deficiencies, supervisory issues, compliance with Reg BI and Form CRS, and deficiencies at private fund advisers
 - Funds' focus on fees and expenses, conflicts of interest, allocation practices, valuation disclosures, investing consistently with disclosed investment strategy
 - Policies, procedures, controls and practices
- Pandemic related disclosures, changes and strategy changes
- New 10-year statute of limitations for disgorgement and sanctions in fraud cases; Letter to the Court Jan. 29, 2021 in pending case
- Broken Windows “Reborn”

Potential Examination Focus

- Private Fund Unit sophistication and influence
- Increased appetite for enforcement referrals
- Delay in publishing 2021 Exam Priorities
- Continuation of prior risk/focus areas
 - Retail Investors
 - Conflicts of Interest
 - Undisclosed Fees and Expenses
 - Insider Trading & Material Non-Public Information

Additional focus on new risk areas

- Market Abuse (Order flow, shorting irregularities)
- SPACs
- Alternative Data
- CLOs/Distressed Credit

Implications, Issues & Solutions

Examination Preparation

- Know your high-risk activities, practices and regulatory risks
- More important than ever – First impressions are paramount
- Expect initial exam within 12-24 months
- Monitor what is publicly available about your firm
- CCO engagement in business is critical
- Review SEC Risk Alerts and guidance
- Engage in compliance training
- Ensure you are doing what your Compliance Manual says
- Ensure your disclosures are consistent with your practices

Enforcement Avoidance Strategies

- Prompt remediation
- Increased need for cooperation

Implications, Issues & Solutions

Enforcement Liability Implications

- Individual Liability Emphasis
- Focus on Board Responsibility
- Flux in Disgorgement Issues = More Penalties
- Waivers from disqualification less likely

Summary

High Probability of a More Volatile Regulatory Environment Ahead



Increased Risk of Return to a “Broken Windows” Enforcement Theory

Adequately Assess Internal Risk Factors to Avoid Scrutiny & Liability

Presenter Contact Information

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