OPERATIONAL DUE DILIGENCE

January Briefing

January 21, 2021

9:00-10:30 AM EST

Moderated by:

Greg Florio
Jim Leahy

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About Orical

The Orical family of companies provides investment advisory legal and compliance services and leads investment management compliance technology in one unified offering[1]. Orical LLC is an investment management compliance consulting firm founded in 2010. With both U.S. and international clients, Orical services some of the financial industry's most well-respected firms, including investment managers, broker-dealers, family offices and banks. The premier law firm and extensive in-house industry experience of our professionals enables Orical to provide timely, practical advice and hands-on assistance that reflects a comprehensive understanding of the real-world issues facing today's industry participants. Our business model is to provide exceptionally responsive and cost-effective expert compliance services. Orical, together with its affiliates, Florio Leahy LLP, an investment management law firm, and REAL World Compliance LLC, a compliance software firm, provides a full suite of investment management services, including the following:

- Registration Services (RIA, CPO/CTA, B-D);
- Development and Administration of Customized Compliance Programs that Represent the Industry's Best Practices;
- Compliance Software;
- Forensic Trading Reviews (Anti-Insider Trading and Market Manipulation Surveillance);
- Assistance with Investor Due Diligence;
- Assistance through Regulatory Examination;
- Mock Examinations (SEC/FINRA/CFTC);
- CCO Training Programs, Guidance and Education;
- Periodic Regulatory Updates;
- Compliance Training;
- Compliance Initiatives, Including in the Areas of Marketing and Performance Reporting, Investment Allocation, Expense Allocation, Conflicts of Interest, Disclosure, SEC Readiness, Custody, Cybersecurity, Disaster Recovery and Books and Records Compliance; and
- Expanding the Bandwidth of our Client's Internal Personnel.

[1] Legal services are provided by Florio Leahy LLP and compliance technology is provided by Real World Compliance LLC, both of which are under common ownership and control with Orical LLC.

About the Operational Due Diligence Briefings

Orical's Operational Due Diligence Breakfast Briefings are a series of informative conferences designed to cover the topics of most significance to the alternative asset operational due diligence community and investors. Briefings are open to all alternative asset ODD professionals and the principals and operational staff of Orical's clients, including hundreds of alternative asset managers. Topics are chosen with input from the ODD professionals, Orical's clients, and Orical's broader network, with 2-3 topics covered in each Briefing. Orical's goal in conducting the briefings is to foster an exchange of information in an open and "off the record" format. The briefings aim to help participants better understand how the industry's best practices apply in different settings and, ultimately, to increase the likelihood of success for alternative asset ODD professionals, investment managers, and investors alike.

Topic 1: SEC Guidance on COVID-19: What Have We Learned?

I. Current Impact on Investment Managers

Effects on the Credit Markets[1] (Link)

The report's purpose was to, among other things, discuss the effects of COVID-19 on the U.S. credit markets and how those markets have, and continue to, function during the pandemic. The report provides an overall examination of the U.S. credit markets and its key market segments. As effects on the economy and credit markets from COVID-19 continue to unfold, the SEC will be paying close attention to key market segments, such as corporate debt, municipal securities, and commercial real estate.

What the SEC is Saying: COVID-19 OCIE Risk Alert[2] (*Link*)

In August 2020, the Securities Exchange Commission's (the "SEC's") Office of Compliance Inspections and Examinations ("OCIE") issued a risk alert to identify heightened risks and issues for investment advisers ("Advisers") and broker-dealers due to COVID-19 and the resulting market volatility.

Protection of Investors' Assets

Advisers' practices regarding collecting and processing investor checks and transfer requests have changed during the pandemic. Accordingly, Advisers should review their practices. For example, if Advisers are not retrieving their mail daily, they should update their policies and procedures to reflect these adjustments. In terms of disclosures, an Adviser may disclose to investors that checks or assets mailed to its office location may experience delays in processing until their personnel can access the mail or deliveries at that office location. Advisers and certain broker-dealers are obligated to transmit investor checks promptly.[3]

Advisers may need to update their policies and procedures if investors are taking unusual or unscheduled withdrawals from their accounts, particularly COVID-19-related distributions from their retirement accounts.

Supervision of Personnel

Advisers should consider reviewing and modifying supervisory and compliance policies and procedures to reflect remote working. In particular, this may be necessary if: an Adviser's supervisors no longer have the same degree of oversight and interaction with supervised persons, electronic communications are conducted outside of the firm's systems, or off-site due diligence reviews are limited. Additionally, Advisers should consider limitations on due diligence and background checks when onboarding personnel, whether supervised persons are making securities recommendations in markets with a greater risk of fraud or volatility, and in general, remote oversite of trading.

Practices Relating to Fees, Expenses, and Financial Transactions

The pandemic may have pressured some firms to compensate for lost revenue due to market volatility. This event could have increased misconduct surrounding financial conflicts of interest and the fees and expenses charged to investors. These include, but are not limited to:

1. over-charging advisory fees or miscalculations of tiered fees;
2. borrowing loans from investors; and
3. providing recommendations that are at a higher cost to investors but benefit supervised persons.

Advisers should ensure that their disclosures and calculations of fees and expenses are accurate, that it is monitoring any transactions that created higher fees and expenses, and that it fully evaluates risks from investors' borrowing loans and other conflicts of interests.

Investment Fraud

Advisers should be mindful of fraudulent offerings when conducting due diligence on investments, and should ensure that its investments are always in the best interests of investors.

Business Continuity

Advisers should review business continuity and disaster recovery policies and procedures to ensure that they can operate in emergency events. If supervised persons are working from home due to the pandemic, an Adviser may need to consider the compliance issues and risks that could impact operations. For example, supervised persons may need to take on expanded roles. Advisers should consider whether it should augment their security and support infrastructure regarding remote workspaces. Policies and procedures need to be reviewed and updated regarding working remotely to protect investors and continue business operations.

The Protection of Investor and Other Sensitive Information

Advisers should protect investors' personally identifiable information ("PII"). Advisers using videoconferencing and other forms of electronic communications, such as increased use of personal devices while working remotely, need to ensure that PII is protected. Additionally, Advisers must be mindful of the risks of supervised persons having physical records at remote locations and the risks associated with the absence of personnel at offices. Cybersecurity risks, including phishing and spoofing, also require special attention. Ensure that devices are password-protected and that encrypted technologies and system access security, such as duo-factor authentication, are in place to enhance protection.

Challenges Due to COVID-19 and Compliance Deficiencies: Comments from SEC Panel on Registered Funds[4] *(Link)*

The four main topics discussed during the SEC panel include supervision, examinations, compliance deficiencies, and disclosure issues.

II. Impact Going Forward in 2021

SEC COVID-19 FAQ[5] *(Link)*

Exams

In its recent FAQ, the OCIE stated that it "is fully aware of the regulatory relief that provided to registrants in response to COVID-19" and that "reliance on regulatory relief will not be a risk factor utilized in determining whether OCIE commences an examination."[6]

Form ADV

If supervised persons are temporarily teleworking as part of the Adviser's business continuity policies and procedures, the SEC would not recommend an enforcement action if the Adviser does not update Item 1.F or Section 1.F of Schedule D.

Custody Rule Requirements[7] **(Link)**

The FAQ touches upon inadvertent receipt of client securities, distribution of audited financial statements, inability to complete surprise examinations, and privately issued securities.

Topic 2: Regulatory Updates and Enforcement Actions

I. High-Level Trends

Undisclosed Conflicts of Interest

The Adviser's Act is intended to eliminate or expose conflicts of interest. Conflicts of interest, if not eliminated, must be disclosed. In 2020, with regards to undisclosed conflicts of interest, the SEC focused on the impact business practices have on creating risks and conflicts of interest.

First, there is the concept of informed consent, which does not require getting into a particular client's head and analyzing whether such client understands a conflict and provides informed consent. Rather, it is more of an objective standard, where disclosure should put a reasonable client in a position to understand and provide informed consent. Clients may implicitly provide informed consent by entering into or continuing the investment advisory relationship with the Adviser after receiving full and fair disclosure of a conflict. If you know a particular client does not know or understand the nature or import of the conflict, or reasonably should know, then it is not consistent with your fiduciary duty to accept that consent.

The SEC noted that Advisers, when using conflicts of interest disclosures, should not use the term "may" when a conflict actually exists. Using this term is false when a conflict actually exists, and the Adviser must fully disclose the conflict of interest.

A recent, notable case regarding undisclosed conflicts of interest is *In the Matter of WBI Investments, Inc., and Millington Securities, Inc*.[8] WBI Investments Inc. ("WBI") and Millington Securities Inc. ("Millington") made material misrepresentations about the compensation Millington received in an institutional payment for order flow arrangement for routing client orders to certain brokerage firms for execution ("executing brokers"). While WBI and Millington, in their roles as Advisers, disclosed the payment for order flow arrangement to their clients, they also materially mislead the boards of their ETF and mutual fund clients by assuring them that the arrangement did not adversely affect execution prices they received.

Illegal Cross Trading – A Case Study

In the Matter of Palmer Square Capital Management LLC,[9] is a recent SEC action against Kansas-based Palmer Square Capital Management LLC ("Palmer"), a registered Adviser, which was charged by the SEC after making hundreds of illegal cross trades between its clients' accounts. From July 2014 to September 2016, the SEC found that Palmer pre-arranged buys and sells of the same security in the same amount from one client account to another over 350 times. The trades involved approximately forty of Palmer clients, including other Advisers Palmer advised. The SEC found that Palmer failed to engage in a process, based on reasonable inquiry, to determine the average of the highest current independent bid and lowest current independent offer for cross trades involving its Adviser clients. Additionally, the SEC found that Palmer's clients on the purchasing side of the cross trade always paid a markup, which was retained by the executing broker, and that Palmer inaccurately informed the boards of its Adviser clients that it had not conducted cross trades.

According to the order, Palmer caused its Adviser clients to violate the statutory prohibitions against cross trading without complying with the exemption conditions in Rule 17a-7 under the Investment Company Act. Furthermore, Palmer failed to provide required disclosure to and obtain consent from other clients involved in principal trades while failing to adopt and implement appropriate policies and procedures to prevent its violations. The order found that Palmer violated Sections 206(3) and 206(4) of the Investment Company Act and Rule 206(4)-7 thereunder and caused its clients to violate Sections 17(a)(1) and 17(a)(2) of the Investment Company Act and Rule 38a-1 thereunder. Without admitting or denying the findings, Palmer consented to a cease-and-desist order, a censure, and a civil penalty of $450,000.

Cryptocurrencies and Other Digital Assets

While not all cryptocurrencies are securities, most are. There is a consensus that only two cryptocurrencies—Bitcoin and Ethereum—are not securities but are instead commodities. In general, where the SEC has determined that an asset is not a security, the CFTC tends to find the asset is a commodity.

Aside from Bitcoin and Ethereum, the SEC, from all indications, considers all cryptocurrencies to be securities. In 2018, former SEC Chairman Jay Clayton said, "I believe every ICO [initial coin offering] is a security." Whether an asset is a security is determined using the 'Howey test' from SEC v. Howey.[10] The Howey test has three elements: (1) an investment of money, (2) in a common enterprise, (3) with a reasonable expectation of profit derived from the efforts of others. The SEC began significant enforcement actions against digital asset issuers after publishing the "DAO Report" was published on July 25, 2017.[11] The SEC keeps a running list of its cyber enforcement actions—for which there were 23 actions in 2020 alone—and in 2019, the SEC published guidance on the factors it considers crucial in analyzing digital assets.[12]

A recent case, *SEC v. Ripple Labs, Inc.*,[13] illustrates that, in the absence of compelling evidence to the contrary (such as a legal opinion or a statement from the SEC), cryptocurrencies are generally securities. Also, what an asset is labeled as is not dispositive of whether or not it is a security.

William Hinman, Director of the Division of Corporate Finance, gave a speech[14] in June 2018 detailing certain criteria for when a digital asset does not meet the Howey test. Mr. Hinman indicated that if a network is sufficiently decentralized, purchasers have no expectation of making a profit from others' efforts. Based on this criterion, he indicated that Bitcoin and Ethereum are accordingly not securities.[15]

Chief Compliance Officers may not have the time to analyze whether hundreds of cryptocurrencies are securities or not, and also, most likely, would not have the necessary facts. Additionally, traders should probably not be spending excessive amounts of time and energy trading cryptocurrencies in their personal accounts while acting as a fiduciary on behalf of their clients. That is why many firms limit the number of trades that a supervised person can make in a month and have minimum holding periods to prevent day trading.

Anyone holding cryptocurrencies should be able to disclose their account information and transactions in some form. Many digital assets are held on exchanges, such as Coinbase, which permits users to download their transaction records as a spreadsheet. Alternatively, digital assets are held off-exchange in "cold storage," making it harder to produce records.

Important Enforcement Areas

Inadequate Disclosures, Material Misstatements, and Misleading Omissions

In December 2020, the SEC alleged that BlueCrest Capital Management Limited ("BlueCrest") violated sections of the Advisers Act and Securities Act after making inadequate disclosures, material misstatements, and misleading omissions regarding its replacement of its top traders from its flagship fund with an underperforming algorithm, and moving those traders to its proprietary fund. BlueCrest agreed to a cease-and-desist order and censure and to pay over $170 million in penalties.

Marketing Impact, Sustainable and Responsible Investing

Environmental, social, and corporate governance ("ESG") is a big focus area of the SEC regarding corporate issuers and companies. The SEC has found that firms should have more disclosure for ESG-related issues, including those related to emissions, employee turnover and compensation, product quality, and product recalls. The SEC's Asset Management Unit is continuously working to ensure that firms who invest in ESG do not drift from their outlined strategy or guidelines when investing.

False and Misleading Statements

In the Matter of Catalyst Capital Advisors, LLC and Jerry Szilagyi[16] is a case that highlights risks associated with making false or misleading statements. The SEC's complaint alleged that Catalyst Capital Advisors ("Catalyst") and one of its senior portfolio managers misrepresented a mutual fund's risk management procedures. In a settled order, the SEC alleged that Catalyst misled investors by misrepresenting that it followed a strict set of parameters for the Catalyst Hedge Futures Strategy Fund, a Catalyst advised mutual fund that invests primarily in options on S&P 500 index futures contracts. Catalyst and Walczak also failed to manage the fund's risks consistent with the fund's prospectus, which stated that Catalyst would employ strict risk management procedures. During December 2016 and February 2017, the fund lost approximately 20% of its net asset value—more than $700 million.

Improper Valuation and Failure to Follow Valuation Policy and Procedures

In the Matter of Semper Capital Management, L.P.[17] is a case based on improper valuation and failure to follow valuation policies and procedures. The SEC's order alleged that Semper was misleading investors about the performance of its Semper MBS Total Return Fund, a registered open-end investment company, and caused the overvaluation of certain of the fund's securities. Without admitting or denying the findings, Semper agreed to a cease-and-desist order, a censure, and to pay disgorgement of fees of $128,228 and a $375,000 penalty.

II. Regulatory Developments

Changes at the SEC

New Emerging Risk Team at the SEC[18]

The SEC announced a new team at OCIE: the Event and Emerging Risks Examination Team ("EERT"). The focus of the EERT will be to conduct examinations and carry out the OCIE's exam priorities in collaboration with the OCIE exam's team. The EERT will also help firms address and protect themselves against sudden market risks and events that could potentially result in significant threats to their business and investors. Such risks and events include exchange outages, liquidity events, and cyber-security or operational resiliency concerns.

New Web Intake Form for No-Action and Interpretive Letters (November 2020)[19]

The Division of Investment Management (the "Division") issued a staff statement regarding its new web intake for no-action and interpretive letter requests under 17 CFR § 202.1(d). The Division specified certain procedures for submitting a request along with other filing information. Requests submitted through the web intake form should include "all pertinent information," including: the names of all companies and persons involved; the specific subsection of the statute to which the letter pertains; a description of the problem and the reasons why the requestor believes the problem exists, including any legal analysis; and the name of the requestor's counsel if the request involved potentially "market-moving" information and/or the requestor does not want to provide its name.

The Division will not answer hypothetical questions. A request for confidential treatment and its basis should be included in a separate letter and submitted with the request letter. Requestors should not provide any sensitive, personally identifiable information on the web form.

Rulemaking

Whistleblower Program (September 23, 2020)

On September 23, 2020, the SEC adopted a final rule to the whistleblower program under Section 21F of the Securities Exchange Act. The amendments enhance the clarity and transparency of the program and create greater incentives for whistleblowers. The amendments clarify certain definitions, including the definition of "whistleblower," enhance the review and processing of whistleblower claims, and update the award determination process, among other efficiencies, to increase the processing speed and number of awards. Whistleblowers with potential awards of less than $5 million (which historically have represented approximately 75% of all whistleblower awards) will, subject to certain criteria, be able to qualify for a presumption that they will receive the maximum statutory amount. The SEC will evaluate other awards in a manner consistent with past practice.

The amendments affirm that award amounts are to be determined exclusively based on the application of the award factors specified in the SEC's whistleblower rules. There will no longer be a separate (post-application of the award factors) assessment of whether award amounts are too small or too large. The amendments clarified that the SEC may waive compliance with the TCR filing requirements if a whistleblower complies with the requirements within 30 days of first providing the information or obtaining actual or constructive notice of the TCR filing requirements. The amendments grant the SEC the ability to make award payments to whistleblowers based on money collected due to deferred prosecution agreements and non-prosecution agreements, and settlements entered into by the SEC outsider of a judicial or administrative proceeding.

Additionally, the SEC published interpretive guidance to clarify the meaning of "independent analysis" under Exchange Act Rule 21F-4 and used in award applications.

Updates to the Accredited Investor Definition and QIB Definition[20]

The SEC adopted amendments to the "accredited investor" definition in its rules and the "qualified institutional buyer" ("QIB") definition in Rule 144A of the Securities Act of 1933.

Updates to the "accredited investor" definition added:

1. Adding a new category for defined measures of professional knowledge, experience or certification, permitting the SEC to reevaluate or add certifications, designations, or credentials in the future;
2. Regarding investments in a private fund, "knowledgeable employees" who are natural persons are;
3. LLCs with $5 million in AUM are also included;
4. SEC- and state-registered Advisers, exempt reporting Advisers, and rural business investment companies ("RBICs");
5. "Family offices" with at least $5 million in AUM and their "family clients," as both terms are defined under the Advisers Act of 1940; and
6. The term "spousal equivalent", so such individuals may pool their finances to qualify as an accredited investor.

Updates to the QIB definition added:

1. LLCs and RBICs if they meet the $100 million in securities owned and invested threshold; and
2. Any institutional investor that satisfies the $100 million threshold that is not otherwise enumerated in the definition of QIB.

Updates to the Advertising and Solicitation Rules

The SEC finalized amendments to create a single modernized marketing rule (the "Rule") that replaces the current advertising and cash solicitation rules. The Rule as adopted departs from the proposed rule in certain ways, including the definition of "advertisement." The Rule adds a list of general prohibitions that draw from previous no-action letters. The SEC also amended Form ADV to include a section on marketing and Rule 204-2, the books and records rule. The Rule's compliance date is 18 months after the Rule's effective date, which is 90 days after being published in the federal register. As of February 1, 2021, the Rule has not been published in the federal register.

Definition of Advertisement

The new amended definition of "advertisement" contains two prongs: one prong capturing communications traditionally covered by the advertising rule, and the other prong governing solicitation activities previously covered by the cash solicitation rules. The first prong includes any direct or indirect communication an Adviser makes that (1) offers the Adviser's investment advisory service regarding securities to prospective clients or private fund investors, or (2) offers new investment advisory services regarding securities to current clients or private fund investors. Note, however, that this prong excludes most one-on-one communications among other exclusions. The second prong generally includes any endorsement or testimonial that an Adviser provides cash and non-cash compensation directly or indirectly (e.g., directed brokerages, awards or other prizes, and reduced advisory fees).

Anti-Fraud Prohibitions

The Rule prohibits the following advertising practices:

1. Making any untrue statement of material fact, or omitting a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading;
2. Making a material statement of fact that the Adviser does not have a reasonable basis for believing that it will be able to substantiate upon demand by the SEC;
3. Including information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact related to the Adviser;
4. Discussing any potential benefit without providing fair and balanced treatment of any associated material risks or limitation;
5. Referencing specific Adviser advice provided by the Adviser that is not presented in a fair or balanced manner;
6. Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and
7. Including information that is otherwise materially misleading.

Testimonials and Endorsements

The Rule prohibits using testimonials and endorsements unless the Adviser satisfies certain disclosure, oversight, and disqualification provisions. Advertisements must prominently disclose whether the person giving the testimonial or endorsement (the "promoter") is a client and whether the promoter is compensated. Additional disclosures are required regarding compensation and conflicts of interests. The Rule provides some exceptions for SEC-registered broker-dealers and eliminates the current rule's requirement that the Adviser obtains from each investor acknowledgment of receipt of disclosures.

An Adviser using testimonials and endorsements in an advertisement must oversee compliance with the Rule. Additionally, an Adviser must enter into a written agreement with promoters, except where the promoter is an affiliate of the Adviser or the promoter receives de minimis compensation ($1,000 or less, or the equivalent value in non-cash compensation, during the preceding 12 months). The Rule prohibits (1) certain "bad actors" from acting as promoters, subject to exceptions, (2) the use of third-party ratings in an advertisement unless the Adviser provides disclosures and satisfies conditions related to the preparation of the rating, and (3) with regards to performance information, the following included in any advertisement:

1. Gross performance without also presenting net performance;
2. Any performance results, unless they are provided for a specific time period in most cases;
3. Any statement that the SEC has reviewed and approved any calculation or presentation of performance results;
4. Performance results of a subset of investments from a portfolio, unless the advertisement offers, or provides, or offers to provide promptly, the performance results of the entire portfolio;
5. Hypothetical performance (not including performance generated by interactive analysis tools), unless the Adviser adopts and implements policies and procedures reasonably designed to ensure that the performance is relevant to the likely financial situation and investment objectives of the intended audience and the Adviser provides certain information underlying the hypothetical performance; and
6. Predecessor performance, unless there is an appropriate similarity regarding the personnel and accounts at the predecessor Adviser and the personnel and accounts at the advertising Adviser. Additionally, the advertising Adviser must include all relevant disclosures clearly and prominently in the advertisement.

Derivatives Final Rule[21]

In a recent Compliance Outreach Program (full program available here), panelists discussed the derivatives final rule, Rule 18f-4 under the Investment Company Act, and the SEC's proposed fair value rule, Rule 2a-5 under the Investment Company Act (discussed below). Regarding the derivatives final rule, panelists noted that modernizing the regulatory framework for funds' use of derivatives has been an SEC's longstanding goal. Under the rule, a fund can enter into derivatives transactions subject to certain conditions (and only a few were mentioned during the panel).

Proposed Valuation Rule 2a-5[22]

Before Proposed Rule 2a-5 (the "Proposed Rule"), the last time the SEC addressed valuation under the Investment Company Act was in a pair of releases issued in 1969 and 1970. Generally, to value a security under the Investment Company Act would require first analyzing whether the security has a market quotation. If so, the security is priced at that price. Second, an investment's fair value is determined in good faith by the board of directors for all other cases. The Proposed Rule provides requirements for fair value of investments and specifies a board's process to assign a fair value to the security and fulfill the board's oversight obligations. The Compliance Outreach Program panelists mentioned that pricing services have become more prominent since the last valuation releases.

III. Enforcement Actions and Common Issues in the OCIE Exams

Observations of Multi-Branch Advisers[23] *(Link)*

Risk Alert: OCIE Observations: Investment Adviser Compliance Programs[24] **(Link)**

The following are notable compliance issues related to Rule 206(4)-7 (the "Compliance Rule") under the Advisers Act, which have been some of the most common deficiencies last year: inadequate compliance resources, insufficient authority of chief compliance officers ("CCOs"), annual review deficiencies, implementing actions required by written policies and procedures, maintaining accurate and complete information in policies and procedures, and maintaining or establishing reasonably designed written policies and procedures.

Risk Alert: Observations from Examinations Investment Advisers Managing Private Funds[25] **(Link)**

The risk alert outlined deficiencies discovered by OCIE in recent exams regarding conflicts of interest, fees and expenses, and policies and procedures relating to MNPI. Such conflicts include, but are not limited to: investment allocations, preferential liquidity rights, Adviser interests in recommended investments, co-investments, service providers, portfolio company fees, and failure to disclose operating partners' compensation.

Section 206 of the Advisers Act prohibits Advisers from employing any device, scheme, or artifice to defraud any client or prospective client, and from engaging in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Advisers must eliminate or make full and fair disclosure of all conflicts of interest that may incline an Adviser to, consciously or unconsciously, render advice that is not disinterested such that a client can provide informed consent from a conflict. Additionally, Rule 206(4)-8 of the Adviser's Act prohibits Advisers to pooled investment vehicles from making untrue statements of material facts or omitting to state a material fact necessary to make the statements made, in light of the circumstances, not misleading, or otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative regarding any investor or prospective investor in the pooled investment vehicle.

Section 204A of the Advisers Act requires investment Advisers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent misuse of MNPI. Advisers Act Rule 204A-1, the "Code of Ethics Rule," requires a registered investment Adviser to adopt and maintain a code of ethics detailing standards of conduct expected of advisory personnel and that addresses conflicts arising from personal trading by advisory personnel. OCIE staff observed the conflicts of interests regarding inadequately disclosed conflicts of interests, fees and expenses, MNPI and Rule 204A-1.

Annual 2020 Report: Division of Enforcement Action[26] *(Link)*

At the beginning of the pandemic in March, the SEC began conducting remote exams and created the Coronavirus Steering Committee to investigate misconduct in fraud, insider trading, microcap, and issuer disclosure. From mid-March through the end of the fiscal year, the Division of Enforcement's (the "DOE's") Office of Market Intelligence triaged approximately 16,000 tips, complaints, and referrals (a roughly 71% increase over the same period last year). The DOE opened more than 150 COVID-related inquiries and investigations and recommended several COVID-related fraud actions to the Commission. There were over 700 enforcement cases in 2020, down from 862 in 2019. Since mid-March, 492 enforcement actions were recommended, and 36 COVID-related trading suspensions opened approximately 640 inquiries and investigations (over 150 of which were COVID-related). In 2020, the SEC charged individuals in 72% of the standalone enforcement actions it brought. Such individuals include those at the top of the corporate hierarchy, including numerous CEOs and CFOs, accountants, auditors, and other gatekeepers. The range of violations included fraud, reporting, books and records, and internal accounting controls.

In 2020, a record year for the Whistleblower Program, the SEC distributed more than $600 million to harmed investors. Additionally, in 2020 the Commission increased the rate at which whistleblower claims were evaluated and awards were issued. The number and amount of whistleblower awards exceeded prior years. Awards issued in 2020 accounted for roughly 37% of the total number of individuals awarded over the whistleblower program's entire life.

Topic 3: Looking Ahead to 2021

I. Changes at the SEC

New SEC Commissioner and New SEC Chairman

Commissioner Crenshaw, the new SEC Commissioner was sworn into office on August 17, 2020. While the new SEC Chairman has not yet been formally appointed, there were a series of potential candidates, including former CFTC Chairman Gary Gensler, former U.S. Attorney for the SDNY Preet Bharara, U.S. District Judge Valerie Caproni, and Representative Katie Porter. Gensler is reportedly President Biden's pick for Chairman. His biography is here and a summary is below.

Gensler served as Chairman of the CFTC from May 26, 2009, to January 3, 2014. During his tenure, in the wake of the 2008 financial crisis, Gensler advocated for bringing financial reform to the vast, unregulated swaps market. Gensler also led the agency as it brought charges against five financial institutions for the manipulation of LIBOR and other benchmark interest rates, resulting in over $1.7 billion in penalties. Gensler previously served at the U.S. Department of the Treasury as Under Secretary of Domestic Finance (1999-2001) and as Assistant Secretary of Financial Markets (1997-1999). He subsequently served as a Senior Advisor to Senate Banking Committee Chairman Paul Sarbanes on the Sarbanes-Oxley Act, which reformed corporate responsibility, accounting and securities laws.

II. What the New Administration Means for the SEC[27]

Potential areas of focus of the SEC include: requiring companies to disclose their political donations in a standardizing way; amending rules regarding stock buybacks by imposing preconditions or more disclosures; requiring corporate disclosures regarding boardroom diversity; mandating climate change-related disclosures; and providing clearer rules on cryptocurrencies and blockchain technology. Commissioner Lee and newly appointed Commissioner Crenshaw have already advocated for increased disclosure in private markets.

Some private practitioners speculate that SEC inspections and enforcement will increase under the Biden Administration. Additionally, while the enforcement division is likely to maintain focus on retail investors, a Biden appointee could also reprioritize more traditional enforcement areas. For example, insider trading cases filed under the Trump Administration reached lows not seen since the Reagan Administration. However, according to the SEC, enforcement actions brought between 2017 and 2020 were about the same as between 2013 and 2016. OCIE Examinations, on average, were greater from between 2017 and 2020 than between 2015 and 2016.

Democratic control of the Congress permits the party to use the Congressional Review Act ("CRA") to overturn regulations finalized by the Trump Administration in the previous 60 legislative days using a fast-track process that requires a simple majority vote. Certain SEC final rules, including the recent amendments to the shareholder proposal rule that curbed shareholder proposals, could be overturned using the CRA.

Partner Biographies

Gregory Florio & James Leahy

Gregory Florio, Founder, Co-Managing Partner/Member

Gregory L. Florio is the founder of Florio Leahy LLP and Orical LLC. With over 20 years of legal and regulatory experience, Mr. Florio is an expert in all aspects of investment management law and regulation, including the Investment Advisers Act of 1940, the Investment Company Act of 1940 and all other laws, rules and regulations that govern the securities industry. His practice focuses on the private fund industry, including formation, structuring, offering terms, private funds, separately managed accounts, compliance programs, regulatory examinations, investigations, enforcement actions and compliance technology. He routinely advises and represents investment managers, broker/dealers, family offices and other financial institutions in connection with their legal and compliance needs. Mr. Florio also directs the Firm's technical solutions effort, Real World Compliance LLC ("REAL"), a product he designed and developed. Before founding the Firms in 2010, Mr. Florio was a Senior Counsel and the Chief Compliance Officer of a multi-billion-dollar global fund manager, Marathon Asset Management, LP ("Marathon"). Before joining Marathon, Mr. Florio was an associate and regulatory specialist in Seward & Kissel ("S&K") LLP's Investment Management Division and, before S&K, was an attorney for the Investment Funds Group at Sidley Austin LLP. After graduating from Fordham University School of Law in 1995 with honors, Mr. Florio began his career serving as an assistant district attorney in New York City. Mr. Florio holds a Bachelor's degree in Consumer Economics from Cornell University and is a member of the New York State Bar Association.

Experience Highlights

- Successfully assisted hundreds of firms through the SEC/CFTC registration and examination process.
- Assisted Marathon through the financial crisis commonly referred to as the "Great Recession", during which time the firm not only gained assets, but was also selected to manage assets for the U.S. Treasury as part of the U.S. Government's Legacy Securities Public-Private Investment Program, after an application process that included well over 100 institutional asset manager applicants.
- Qualified as an expert witness in high profile criminal cases related to SEC enforcement actions.
- Commonly referenced as an expert in investment adviser regulatory compliance, and anti-insider trading and market manipulation surveillance.
- Since 2002, has been a leader in designing technical solutions to address operational difficulties in the investment adviser and broker/dealer compliance arenas, including designing and developing Orical's compliance software, REAL.

James M. Leahy, Co-Managing Partner/Member

James M. Leahy is Co-Managing Partner of Florio Leahy LLP and Co-Managing Member of Orical LLC with 29 years of capital markets, securities, operations, and legal experience. Mr. Leahy prepares his clients for and assists them with regulatory examinations. He has extensive experience assisting firms to identify enterprise and compliance risks and conflicts; he also assists with the development, implementation and testing of firm-specific policies, procedures and disclosures tailored to mitigate those risks and conflicts. Mr. Leahy is a frequent author and speaker concerning regulatory developments impacting the fund industry. He conducts due diligence for several active fund investors, drafts fund offering documentation and negotiates a variety of contracts on behalf of funds and fund service providers.

Prior to joining Orical in 2013, Mr. Leahy served as Chief Financial Officer of Marathon Asset Management, LP where he managed teams of professionals responsible for tax, accounting, operations and internal audit. Mr. Leahy's responsibilities included monitoring cash, profit and loss as well as financing lines and relations with external service providers such as prime brokerage, ISDA counterparty, audit, valuation and fund administration. Mr. Leahy met regularly with investor due diligence teams. He also spent significant time on governance, conflicts, allocation, valuation, best execution, cross trade, side pocket and liquidating fund issues, particularly during the last financial crisis.

Prior to Marathon, Mr. Leahy was a Vice President, Senior Credit Officer and Team Leader at Moody's Investors Service and was also a member of the CDO team. He helped found the Hedge Fund Operations Quality business where his group was responsible for assigning Operational Quality Ratings to hedge funds. Prior to Moody's, Mr. Leahy was a lawyer at Skadden, Arps, Slate, Meagher & Flom LLP and Milbank, Tweed, Hadley & McCloy LLP in New York City. His legal practice involved corporate, securities and financing transactions. He has comprehensive knowledge regarding public and private placements of securities and has negotiated many lending facilities, debt instruments and structured finance transactions.

Prior to practicing law, Mr. Leahy was a Surface Warfare Officer in the United States Navy. He served aboard three warships, designed curriculum and taught at the Navy's Gas Turbine Engineering School in Newport, Rhode Island. Mr. Leahy holds an honors law degree from Boston College Law School and an undergraduate degree in English from Dartmouth College. Mr. Leahy is a member of the Bar in New York and Massachusetts.

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