



Alternative Asset Management General Counsel Webinar: SEC Enforcement and Examination Trends for Registered Investment Advisers

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Eileen advises hedge funds, venture capital funds and other pooled investment vehicles in connection with capital raising, structuring, formation, investor negotiations, and ongoing operations. Offering the benefit of extensive experience, Eileen negotiates seed and strategic investments, funds-of-one, managed account arrangements, and other alternative investment relationships. She also regularly advises asset managers and institutional investors with respect to co-investments.

Her practice is focused particularly on the business arrangements between the principals of asset management firms, including governance of the investment manager and general partner entities. She also structures and negotiates employee compensation and employee separation arrangements for both asset managers and their most senior employees.

Eileen works closely with clients to understand their business goals and commercial needs. She provides efficient, practical legal advice to a variety of clients, from family-owned enterprises to multinational asset managers.

Honors & Awards

- *Chambers USA*: America's Leading Lawyers for Business (2021): Ranked for work in Hedge Funds: USA – Nationwide



Education

- Seton Hall University School of Law (J.D. 2009), summa cum laude
- Drew University (B.A. 2006), summa cum laude

Bar Admissions

- New York
- New Jersey

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Highly respected by industry peers for his depth of regulatory knowledge, Scott has counseled hundreds of investment management clients in the implementation of compliance programs, as well as in the development of plans to ensure ongoing adherence to emerging regulatory standards.

He possesses a thorough knowledge of the entire panoply of the overlapping securities and commodities laws, rules, and regulations affecting his clients. Scott is part of a team that "always understands the issues at hand, responds very quickly and is able to suggest creative solutions to issues that are often very complicated." (*The Legal 500*)

Scott's extensive experience includes representing offshore and U.S.-based funds, investment advisors, broker-dealers, commodity pool operators, and commodity trading advisors in formation and structuring, securities and commodities regulation, mergers and acquisitions, and other financial transactions. Scott is "very responsive, thoughtful, commercial and professional. He has a good command and very encyclopedic knowledge of the Investment Advisers Act." (Chambers USA)

Honors & Awards

- Chambers USA: America's Leading Lawyers for Business (2019-2021): Ranked for work in Investment Funds - Regulatory & Compliance – Nationwide
- Chambers Global: Ranked for work in Investment Funds: Regulatory & Compliance – USA (2021)



Education

- Seton Hall University School of Law (J.D. 2001), magna cum laude; Notes Editor, *Seton Hall Law Review*
- Bentley College (B.S. 1998), magna cum laude

Bar Admissions

- New York
- New Jersey

An Initial Assessment: Early Indication of Themes or Priorities?

- Very broad range of topics being taken up by the Division of Examinations.
 - Enforcement will be selective in determining what actions to bring.
 - Division of Examinations can resolve issues outside of enforcement.
- Be prepared for detailed inquiries and multiple follow-on requests during examination.
- Do what you say you will do.
- Update your risk assessment and conflicts assessment.



Examination and Enforcement Trends: The Oldies but Goodies

- Cybersecurity
- Vendor Review
- Business Continuity/Branch Office Supervision
- Conflicts of Interest
- Valuation
- Allocation of Investment Opportunities and Expenses
- Material, Non-Public Information
- Marketing
- Empowering Chief Compliance Officers and Maintaining Robust Compliance Policies and Procedures

Cybersecurity & Vendor Review

- Firms must adopt procedures that seek to prevent a breach, as well as respond to a breach.
- The SEC (and investors) expect extensive due diligence and monitoring of vendors.
 - Representations in vendor agreements are necessary but not sufficient.
- Electronic systems are more important than ever in the current work-from-home environment.
- The SEC brought a recent enforcement action alleging cybersecurity failures involving cloud-based e-mail systems.
- Takeaway: Need detailed risk assessment and testing.



Business Continuity Plans

- In a post-lockdown world, the SEC is focused on assessing the strengths and weaknesses of how business continuity plans actually worked during the pandemic.
- Specifically, the SEC is considering whether firms have thoughtfully and fully analyzed the strengths and weaknesses in the plans.
- Using COVID as an excuse for a delay can raise more questions than it answers.



Branch Office Supervision

- Updated April 6, 2021, the SEC issued a FAQ allowing temporary relief from reporting home office locations on Form ADV in limited circumstances.
- While we expect that the industry will develop norms and best practices with respect to the new way of working, it currently is unclear how much the SEC will focus on treating home offices as branch offices.
 - The NFA has proposed more permanent branch-office relief for home offices.
- Takeaway: If your employees will work from home on a permanent basis, you likely will need to update your Form ADV to list that home office as a branch location. Ensure that all employee offer letters and/or your employee handbook include an acknowledgment from employees that their home address might be listed in the firm's regulatory filings.
- Takeaway: If your firm is not SEC-registered, make certain that you have conducted a state-level investment adviser analysis in every state in which you have employees, including employees working from their homes.
 - And, even if SEC-registered, firms still need an investment adviser representative analysis state-by-state.

Conflicts of Interest – Timing of Disclosure

- As we have seen for several years, the SEC remains highly-focused on complete and accurate disclosure of conflicts of interest, particularly with respect to fees and expenses.
- Specifically, the SEC has focused on the timing of disclosure. For example, in a settled enforcement action with Monomoy Capital Management, L.P., the SEC found a deficiency because the timing of the disclosure.
- Takeaway: If you are updating conflicts disclosure in your private placement memorandum, also update the disclosure in your Form ADV before accepting any new capital.
 - Form ADV may also allow for faster disclosure updates than fund offering documents, so long as the disclosure is consistent with the fund offering documents.

Conflicts of Interest – The Dreaded “May”

- Also in the Monomoy settled enforcement action, the SEC emphasized that disclosure was inadequate if it described that the manager “may” engage in certain activities or receive certain fees if the manager actually was engaging in those activities or receiving those fees.
- Conditional language is misleading if the conflicts actually are occurring.
- Takeaway: Carefully scour your disclosure documentation and Form ADV to scrub away the “mays” and fully describe whether the facts surrounding the conflict actually exist today.
- Takeaway: Review your disclosure documentation and Form ADV to ensure not only that they fully describe a conflict, but also adequately describe the potential consequences of the conflict.

Conflicts of Interest – Valuation and Allocation of Investment Opportunities/Expenses

- Allocation of expenses has been a focus of the SEC for several years.
- The SEC has increasingly focused on valuation, bringing multiple enforcement actions even on level 3 assets.
- Fair allocation of investments (on both purchase and sale) remains a priority.
- Takeaway: Ensure that your disclosure documents and Form ADV accurately reflect how you allocate investments and expenses and ensure that compliance with your allocation policies are fully memorialized.
- Takeaway: If you manage liquid funds, confirm that your disclosure documents describe that the withdrawal terms of various funds and accounts may be more favorable than others. Ensure that the disclosure explains that if one fund or account in the same strategy has a material redemption, it could impact the pricing of the same securities held by other funds and accounts with the same strategy.
- Takeaway: Don't think you will get a pass on fair value procedures. The SEC will look hard to make sure valuation is reasonable and that fair value procedures were disclosed and followed.

Conflicts of Interest – Co-Investments

- Takeaway: Ensure that your disclosure documents fully describe how co-investments are allocated and the expenses (including broken deal, research, and deal-level legal expenses) that will or will not be allocated to the co-investors.
- Takeaway: Disclose and document your policy on how co-investors are selected.



Conflicts of Interest – Cross Trades and Principal Transactions

- In 2021, the SEC issued another risk alert on cross trades and principal transactions (after a prior risk alert in 2019 on the same topic).
- Takeaway: Disclose whether cross trades and principal transactions occur (including rebalancing), and have proper procedures in place to mitigate the conflicts and obtain required consents.



Misuse of Material, Non-Public Information

- Strong focus on information flow and the misuse of material, non-public information, including the use of increasingly sophisticated computer programs to find violations of law.
- Recent enforcement actions target information flow (e.g., App Annie) and typical insider trading/front running fact patterns, but also include novel situations (e.g., sympathy trades).
- Takeaway: General policies and procedures on insider trading are no longer sufficient. Policies and procedures, and related disclosure, must specifically contemplate and address every known or reasonably foreseeable source of information.



Marketing

- New marketing rule can be more of the same or a total game changer.
- New marketing rule expressly covers private funds and marketing to investors.
- The compliance date is November 4, 2022.
- Takeaway: Fund offering documents and Form ADV can be considered advertisements under the new marketing rule. Investors can be solicitors.
- Takeaway: Start considering your approach to the new marketing rule sooner rather than later.



Examination and Enforcement Trends: The Next Wave

- ESG
- SPACs
- Digital Assets



ESG – Environmental, Social, Governance

- In April 2021, the SEC issued a risk alert providing guidance to managers with respect to ESG.
- The golden rule of compliance policies: “Say what you do and do what you say.”
- Specifically, the SEC stated that examinations will focus on:
 - Portfolio management, including policies, procedures, and practices.
 - Use of terminology related to ESG.
 - Due diligence and other policies.
 - Proxy voting decision making.
 - Performance advertising and marketing materials.
 - Regulatory filings, websites, reports to sponsors of ESG frameworks, client presentations, DDQs, RFPs.
 - Compliance programs for implementation, compliance oversight, and review of ESG investing practices and disclosures.

ESG – Environmental, Social, Governance

- Without doubt, there will be deficiency findings and enforcement actions hinging on failure to comply with written policies and procedures. ESG is not unique in this respect.
- Takeaway: Thoroughly review your compliance policies and ensure that they describe what you really do in practice. For instance, if the policy requires that you question targeted portfolio companies about ESG during diligence – make sure every diligence report reflects that your team has actually inquired.
- Takeaway: If you indicate that ESG is a part of your strategy or even promise to consider it in a side letter, the SEC will ask you about it during your next exam.

SPACs – Existing Guidance from the SEC

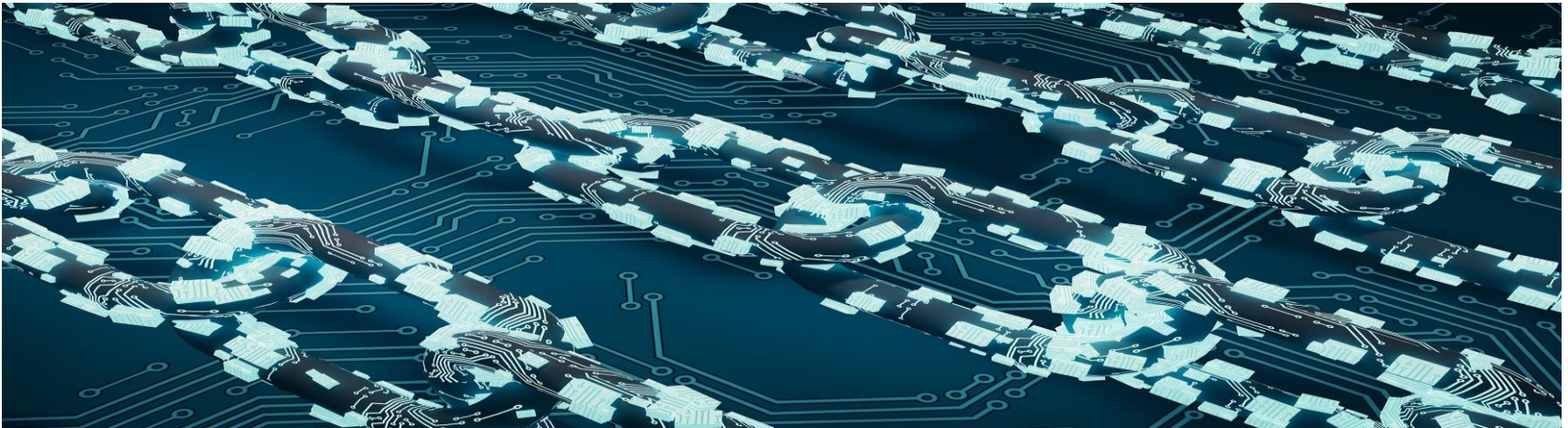
- General Guidance
 - Division of Corporate Finance – December 22, 2020 – CF Disclosure Guidance: Topic No. 11 re: conflicts disclosure.
 - Division of Corporate Finance – March 31, 2021 – Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies re: accounting, financial reporting, and governance issues.
 - Public Statement – April 8, 2021 – John Coates, Acting Director, Division of Corporation Finance re: financial projections and protection of forward-looking statements.
 - Office of Investor Education and Advocacy – May 25, 2021 – What You Need to Know About SPACs – Updated Investor Bulletin.
- Caution Regarding Celebrity Endorsers
 - Office of Investor Education and Advocacy – March 10, 2021 – Celebrity Involvement with SPACs – Investor Alert.
- Classification of Warrants as Liabilities, Rather than Equity.
 - Public Statement – April 12, 2021 – John Coates, Acting Director, Division of Corporation Finance and Paul Munter, Acting Chief Accountant.

SPACs – Anticipated Regulatory Evolution

- Meeting of the SEC’s Investor Advisory Committee – September 9, 2021
 - Voted unanimously to recommend that the SEC increase oversight of SPACs, with focus on disclosure rules.
- Enforcement Actions and SEC-Led Litigation
 - In July 2021, the SEC sued Stable Road Acquisition Corp. and Momentus Inc. alleging that investors were misled regarding the business combination and that Stable Road failed to conduct adequate due diligence on the target.
- Investor Lawsuits
 - According to Cornerstone Research, fourteen class action lawsuits related to SPACs were filed in the first six months of 2021.
- Other Lawsuits
 - A group of lawyers sued Bill Ackman’s SPAC – Pershing Square Tontine Holdings Ltd. – alleging that it should have been registered as an investment company pursuant to the Investment Company Act of 1940.
 - In response, numerous law firms signed an open letter criticizing the suit and alleging it lacked merit.
- Chairman Gensler’s Public Statements

Digital Assets

- The Division of Examinations continues to focus on digital asset securities.
- Risks include portfolio management, books and records, custody, disclosure, valuation and registration.
- Takeaway: Disclosure documents and Form ADV must be clear as to what assets classes are traded and what risks and mitigating procedures relate to those asset classes. This is especially true for emerging and potentially risky asset classes like digital assets.



The First 48: How to Respond When You Get the Call

- Large number of routine examinations.
- Prepare ahead of time.
- Don't panic.
- First day presentations are still typical (just virtual).
- Division of Examinations separated into units, including the private fund unit.
- New registrants can expect a new registrant examination in the first year or two of operations.

Questions from the Audience



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