FORESIDE

Regulatory Update

May, 2022

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FOR INVESTMENT ADVISORS AND BROKER-DEALERS

FINRA 2022 Entitlement User Account Certification Period Announced.

Firms that use the Investment Adviser Registration Depository (IARD) and FINRA to make electronic filings need to review their accounts and certify their authorized users. This year's certification period runs from 6/1/2022 through 8/31/2022. The firm's Super Account Administrator ("SAA") must perform this certification. As a reminder, SAAs will receive an email that includes the start and due date of the certification. Failure to complete the certification by 8/31 will result in all associated user accounts being suspended until the certification is complete. For detailed instructions regarding how to complete the certification, please refer to FINRA's Entitlement Program FAQ. *Contributed by Rochelle Truzzi, Senior Director.*

FOR INVESTMENT ADVISORS

SEC Cautions Advisors to Update Policies on Handling Material Non-Public Information.

The SEC's Division of Examinations ("EXAMS") recently released a risk alert focused on investment advisor code of ethics issues, with specific attention placed on how advisors handle material non-public information ("MNPI"). Foreside's Todd Cipperman also analyzed the release in this article available on the Foreside Knowledge Center.

While the risk alert framed its findings as weaknesses, advisors may wish to consider them as opportunities to confirm their policies and procedures are adequate. The alert's findings fall into two categories:

1. **Specific activities with the potential for increased exposure to MNPI:**
   - **Alternative data providers**[1]: Firms should establish clear procedures regarding their use of alternative data providers, including robust and consistent documentation of due diligence and ongoing reviews.
   - **Value-added investors**: Procedures should address how the firm consistently identifies value added investors and manages the associated risk of exposure to MNPI.
   - **Expert Networks**: The alert largely reiterates previous guidance encouraging firms to implement best practices such as logging and tracking calls and reviewing detailed call notes. EXAMS also shared a new recommendation for firms to review trading activity in similar industries as consultations. While this may be connected with the SEC's ongoing insider trading action against Matthew Panuwat[2], practically speaking this may be a challenge for some firms to implement efficiently.

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1 Footnote 9 of the risk alert notes that "'Alternative data' refers to many different types of information increasingly used in financial analysis, beyond traditional financial statements, company filings, and press releases. Alternative data does not necessarily contain MNPI. Examples of "alternative data" include information gleaned from satellite and drone imagery of crop fields and retailers' parking lots, analyses of aggregate credit card transactions, social media and internet search data, geolocation data from consumers' mobile phones, and email data obtained from apps and tools that consumers may utilize." https://www.sec.gov/files/code-ethics-risk-alert.pdf.

2 "In SEC v. Panuwat, the SEC alleged that Matthew Panuwat used confidential information regarding the acquisition of Medivation, his employer, to buy stock options in another industry participant, Incyte. The court ruled that the SEC alleged facts sufficient to state a claim under the "misappropriation" theory of insider trading for violations of §10(b) of the 1934 Securities Exchange Act and SEC Rule 10b-5 promulgated thereunder." See "Shadow Trading" and "SEC v. Panuwat": An Expansive Trend in Insider Trading Enforcement"? David I. Miller, Robert A. Horowitz, Charles J. Berk, of GreenbergTraurig. March 2, 2022. The New York Law Journal. https://www.gtlaw.com/en/insights/2022/3/published-articles/shadow-trading-and-sec-v-panuwat-an-expansive-trend-in-insider-trading-enforcement

2. **Basic Code of Ethics blocking and tackling**
   Within this category, the alert noted commonly cited deficiencies. Firms are again reminded to consider how they (a) identify access persons, (b) handlie preclearance violations, (c) evidence review of holdings and transaction reports, and (d) obtain code acknowledgements from employees. Additionally, firms should consider controls to prevent CCOs from reviewing their own transactions. Other best practices include maintaining a restricted securities list where the firm possesses MNPI and ensuring that investment opportunities are first offered to clients before the firm or any employee.

> "Most of these findings are not new, however, the fact the SEC issued this alert show that firms continue to struggle in this area"

Most of these findings are not new, however, the fact the SEC issued this alert show that firms continue to struggle in this area. Firms can take this opportunity to tighten their belts and suspenders and consider whether they are doing enough to test and monitor these activities and document those reviews. Several scalable technology solutions also exist to help firms streamline and automate these workflows. *Contributed by Cari Hopfensperger, Senior Director.*

More States Adopt Investment Adviser Representative Continuing Education Requirements.

The following table summarizes the current status of state investment adviser representative ("IAR") continuing education ("CE") requirements. Kentucky, Michigan and Wisconsin and these requirements for 2023, , and Arkansas and Washington D.C. join Nevada with pending proposals. Note that CE requirements apply to any IAR registered in an affected state – whether they are associated with a state-registered, or SEC-registered, advisor. *Contributed by Cari Hopfensperger, Senior Director.*

Effective January 1, 2022 (Completion of the required 12 credits due Dec. 31, 2022)		
Maryland	Mississippi	Vermont
Effective January 1, 2023 (Completion of the required 12 credits due Dec. 31, 2023)		
Kentucky	Michigan	Wisconsin
Proposals Pending Adoption (If adopted in 2022, requirements will be effective Jan. 1, 2023)		
Arkansas	Nevada	Washington, D.C.

FOR BROKER-DEALERS

What are your Sales Practice Obligations when it comes to Alternative Mutual Funds?

FINRA Notice 22-11 provides guidance to firms that offer mutual funds that "seek to achieve their objectives through investments in non-traditional investments or asset classes." Examples include mutual funds investing in digital assets, gold, or implementing complex investment strategies. FINRA's Notice cites common weaknesses that have led to enforcement actions, including inadequate written supervisory procedures, insufficient due diligence processes, lack of oversight of suitability recommendations, and incomplete and unbalanced communications with the public. More importantly, the Notice provides a list of FINRA resources firms should revisit along with a discussion of effective practices for enhancing their supervisory program. The information provided is intended to assist firms in the development of policies and procedures for alternative funds that are designed to comply with the care and compliance obligations under Regulation Best Interest ("Reg BI"). *Contributed by Rochelle Truzzi, Senior Director.*

LESSONS LEARNED

Archegos Case Provides Cautionary Tale for Firms that Ignore Risks.

The SEC filed a complaint against Bill Hwang, the owner of family office Archegos Capital Management, LP ("Archegos"), for orchestrating a fraudulent scheme that resulted in billions of dollars of losses. The facts of the case are complicated, but at its core, the complaint charges Hwang, Archegos, and its firm principals with defrauding the banks that lent them money and acted as counterparties in total return swaps. Unlike other big frauds, the losers in this case were Hwang, since he was playing with his own and his family's money, and the banks that dealt with him. So, although there may be some outcry for further regulation of family offices and the derivatives market, at least some of these losses were caused by a lacking compliance culture at one of the banks involved, Credit Suisse, where losses totaled around $5.5 billion.

By way of background, Archegos founder, Bill Hwang, was a famous hedge fund manager, having worked with Tiger Asia Management, LLC and Tiger Asia Partners. In 2012, Hwang became infamous after pleading guilty to wire fraud related to illegal trading of Chinese stocks and paid $44 million to settle U.S. insider trading charges. Tiger Asia subsequently rebranded as Archegos, a family office. Two years later, Hwang and Archegos were banned from trading securities in Hong Kong for four years. During this entire time, Credit Suisse continued to do business with Archegos without imposing any heightened scrutiny on the relationship.

Obviously lying to business partners is wrong and can result in fraud charges. But from a compliance perspective, the teachable moments in this case come from the fallout at Credit Suisse. Credit Suisse's board of directors appointed a special committee and retained a law firm, Paul, Weiss, Rifkin, Wharton & Garrison LLP ("Paul Weiss") to conduct an investigation, culminating in a report about what went wrong. The report makes fascinating reading, but the big takeaways include:

1. Short-term profits should not override long-term sustainability.
For Credit Suisse, the Prime Services business unit focused on revenue and failed to rein in risk-taking. Allowing the sales team to run the show can result in regulatory trouble.

2. Monitoring and testing are meaningless without accountability and consequences.
As discussed in the Paul Weiss report, the buck did not stop anywhere when it came to managing risk within the Prime Services unit. Despite the many red flags being raised, no one was held accountable when the risks were not addressed. Moreover, there were no consequences for taking undue risks -- until the failed margin call at the end of March 2021.

3. The tone at the top emphasized revenue over managing risk.
When employees who raise questions about risk are consistently ignored by management, the firm sends the message that risk is unimportant.

This quote from the Paul Weiss report sums up Credit Suisse's failures:

> [t]he Archegos default exposed several significant deficiencies in CS's risk culture, revealing a Prime Services business with a lackadaisical attitude towards risk and risk discipline; a lack of accountability for risk failures; risk systems that identified acute risks, which were systematically ignored by business and risk personnel; and a cultural unwillingness to engage in challenging discussions or to escalate matters posing grave economic and reputational risk. The Archegos matter directly calls into question the competence of the business and risk personnel who had all the information necessary to appreciate the magnitude and urgency of the Archegos risks but failed at multiple junctures to take decisive and urgent action to address them."

Contributed by Jaqueline Hummel, Managing Director.

WORTH READING, WATCHING, AND HEARING

Recent Foreside thought leadership

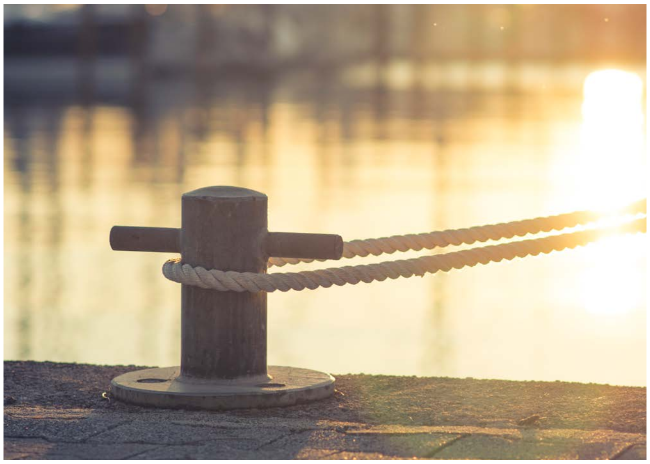
- The SEC Isn't a Goldfish; Examiners Will Remember Your Compliance Problems, by Les Abromovitz.
- Where's a Trusted Contact When You Need One? By Les Abromovitz.

Other resources

Alternative Data Compliance Considerations for Investment Advisers. Jane Jarcho from Promontory IBM Consulting addresses how firms can establish procedures to prevent misuse of MNPI in connection with alternative data.

SEC Division of Examinations (Finally) Speaks on Alternative Data. Akin Gump offers this Financial Regulatory Alert to make some sense of the SEC's focus on the risks associated with alternative data.

Fred Reish, Partner with Faegre Drinker Biddle & Reath LLP maintains a prolific blog where he has been digging into the nuances and nitty gritty of the DOL's Prohibited Transaction Exemption ("PTE") 2020-02. We feel comfortable saying "prolific" as we share these recent posts numbered 87, 88, and 89, respectively.



TO DO CHECKLISTS FOR THE MONTH OF JUNE 2022

INVESTMENT ADVISORS

☑ GIPS Notification Requirement: Firms opting to comply with the Global Investment Performance Standards (GIPS) must notify the CFA Institute of its claim of compliance on an annual basis. This notification is due **June 30, 2022** and should be submitted by completing the appropriate online form on the CFA Institute's website.

HEDGE/PRIVATE FUND ADVISORS

☑ Blue Sky Filings (Form D). Advisors to private funds should review fund blue sky filings and determine whether any amended or new filings are necessary. Generally, most states require a notice filing ("blue sky filing") within 15 days of the first sale of interests in a fund, but state laws vary. Did you know Foreside offers a convenient and economical blue sky filing service to help firms manage this complicated monthly task? Give us a call to discuss your needs further. **Due June 15, 2022**.

☑ Distribute Audited Financial Statements for Private Funds for Funds of Funds: Private fund advisors should have their funds audited by an independent, PCAOB-registered accountant and deliver the audited financial statements to the funds' investors within 120 days of the end of the funds' fiscal year. The deadline for private funds that are fund of funds is 180 days after the funds' fiscal year-end. That's **June 29, 2022,** for funds with a December 31 year-end.

BROKER-DEALERS

☑ Rule 17a-5 Monthly and Fifth FOCUS Part II/IIA Filings: For the period ending May 31. For firms required to submit monthly FOCUS filings and those firms whose fiscal year-end is a date other than a calendar quarter. **Due June 24, 2022.**

☑ **Supplemental Inventory Schedule ("SIS"):** For the month ending May 31. The SIS must be filed by a firm that is required to file FOCUS Report

Part II, FOCUS Report Part IIA or FOGS Report Part I, with inventory positions as of the end of the reporting period, unless the firm has (1) a minimum dollar net capital or liquid capital requirement of less than $100,000; or (2) inventory positions consisting only of money market mutual funds. A firm with inventory positions consisting only of money market mutual funds must affirmatively indicate through the eFOCUS system that no SIS filing is required for the reporting period. **Due June 29, 2022.**

- ☑ **Annual Reports for Fiscal Year-End April 30:** FINRA requires that member firms submit their annual reports in electronic form. Firms must also file the report at the regional office of the SEC in which the firm has its principal place of business and the SEC's principal office in Washington, DC. Firms registered in Arizona, Hawaii, Louisiana, or New Hampshire may have additional filing requirements. **Due June 29, 2022 (Conditional 30-Day Extension may be available).**
- ☑ **SIPC-7 Assessment**: For firms with a Fiscal Year-End of April 30th. SIPC members are required to file the SIPC-7 General Assessment Reconciliation Form, together with the assessment owed (less any assessment paid with the SIPC-6) within 60 days after the Fiscal Year-End. **Due June 29, 2022.**
- ☑ **SIPC-3 Certification of Exclusion from Membership**: For firms with a Fiscal Year-End of May 31 **AND** claiming an exclusion from SIPC Membership under Section 78ccc(a)(2)(A) of the Securities Investor Protection Act of 1970. This annual filing is due within 30 days of the beginning of each fiscal year. **Due June 30, 2022.**
- ☑ **SIPC-6 Assessment**: For firms with a Fiscal Year-End of November 30th. SIPC members are required to file for the first half of the fiscal year a SIPC-6 General Assessment Payment Form together with the assessment owed within 30 days after the period covered. **Due June 30, 2022.**

REGISTERED COMMODITY POOL OPERATORS

- ☑ Form CPO-PQR (March 31 Quarter End): Small, Mid-Sized and Large Commodity Pool Operators are required to file NFA Form CPO-PQR quarterly with the NFA. **Due June 1, 2022**.

MUTUAL FUNDS

- ☑ **Form N-MFP**. Form N-MFP (Monthly Schedule of Portfolio Holdings of Money Market Funds) reports information about the fund's holdings as of the last business day of the prior calendar month and must be filed no later than the fifth business day of each calendar month. **Due June 7, 2022.**

This article is not a solicitation of any investment product or service to any person or entity. The content contained in this article is for informational use only and is not intended to be and is not a substitute for professional financial, tax or legal advice.