Volume 24, Issue 2
February 2024

ORICAL REGULATORY UPDATE

RULEMAKING

SEC Expands Dealer Rule to Certain Proprietary Traders, Private Funds

A divided SEC adopted two rules that will significantly expand the scope of the definition of "dealer" and "government securities dealer" in "another salvo in the commission's war on private funds," according to one Commissioner.

As a result of the expanded definitions, market participants that regularly engage in certain liquidity-providing activity in securities (or government securities) will have to register with the SEC as a "dealer" or "government securities dealer" under Section 15 or Section 15C, respectively. These new rules could require proprietary trading firms, investment advisers and private funds (generally hedge funds) to register as members of the Financial Industry Regulatory Authority and meet certain reporting, recordkeeping and minimum capital requirements, which may impose undue hardships on previously exempted firms (that had relied on the so-called "trader" exception). Many opponents worry that sovereign wealth funds and pension funds could become embroiled in the SEC's new definition, as well as registered investment advisers and their private funds, specifically those that trade algorithmically. The final rules passed explicitly grant an exemption for central banks, certain sovereign entities, international financial institutions and those that have or control total assets of less than $50 million.

These new rules are intended to quell the high-frequency trading strategies commonly pursued, as these can lead to market price swings and, ultimately, market crashes, pointing to the 2010 "Flash Crash" and the 2014 treasury bond crash as two examples of this. Now, those entities that have large trading volumes or pursue algorithmic or high-frequency trading strategies may have to consider the potential ramifications of dealer registration.

Relatedly, in a win for the SEC, an 11th Circuit Court partially affirmed a lower court's judgment that Ibrahim Almagarby operated as an unlicensed dealer, but partially reversed the prior judgment that prohibited his future participation in penny-stock offerings.

Additional Amendments to Enhance Form PF Reporting

On February 8, 2024, continuing an active period for the Commission and its rulemaking, the SEC in combination with the Commodity Futures Trading Commission ("CFTC") jointly adopted *further* amendments to the Form PF, the reporting form for registered investment advisers to private funds, intended to provide greater insight into private fund operations and strategies, assist in identifying systemic risk and reduce reporting errors.

The first additional amendment is for those large hedge fund advisers regarding qualifying hedge funds, i.e., those with a net asset value of $500 million or greater, to include new data relating to borrowing, currency, industry and counterparty exposure, central clearing counterparty reporting, risk metrics and investment performance by strategy, and portfolio and investor liquidity. Another change to Form PF reporting involves the reporting of parallel funds and master-feeder structures. As parallel funds and master-feeder arrangements pursue the same strategies, historically, this data reporting could be aggregated, however, these amendments will generally require separate reporting for each component. Also, for large liquidity and hedge fund advisers, the SEC is now transitioning the reporting time period from a fiscal-year basis, which varied from adviser to adviser, to a calendar-year basis to streamline the data intake on its end. These new rules are likely to come into effect during the beginning of Q2 2025.

Continued Focus on Marketing Practices of Investment Advisers

The SEC released a new frequently asked question ("FAQ") regarding the impact of the new marketing rule on registered advisers displaying performance of private funds that utilize subscription lines (i.e., capital call facilities) in their "advertisements." Per the FAQ, an adviser would violate the rule if it were to advertise its (i) gross IRR calculated from the time when it makes an investment (a fund-level return), alongside (ii) net IRR calculated from the time investor capital is called and the "subscription facility" is retired (an investor-level return). The rule requires that any presentation of gross performance be accompanied by a presentation of net performance that has been calculated over the same time period and using the same type of return and methodology as the gross performance.

UPCOMING COMPLIANCE DEADLINES: Form PF Quarterly: 2/29/2024
Form PQR Quarterly: 2/29/2024, **Form ADV:** 3/30/2024, **Form PF Annual:** 04/30/2024

SEC v. David B. Bodner

The SEC settled charges against David Bodner for approximately $2,454,466 for participating in a series of conflicted transactions from 2013-2016 that defrauded clients. Bodner participated in transactions through an enterprise referred to as "Beechwood," and an investment advisory firm, Platinum Partners ("Platinum"). Bodner had a substantial ownership interest through trusts and entities in Beechwood and was a principal of Platinum. He played a role in Beechwood's investment process and helped cause Beechwood's clients to invest assets both in Platinum and in other investments in which he had personal interests. Bodner also arranged various transactions by which Beechwood provided liquidity to Platinum funds and related portfolio companies and helped those entities to avoid defaults on existing loans issued by Beechwood clients. The SEC found that Bodner did not take steps to ensure that Beechwood disclosed to clients the conflicts presented by those transactions, as well as the purpose of and source of the funds used for these transactions.

REGULATORY UPDATE

Sixteen Firms to Pay More Than $81 Million Combined to Settle Charges for Widespread Recordkeeping Failures

The SEC continues its focus on books and records violations, fining sixteen firms more than $81 million for their failure to maintain and preserve electronic communications, specifically text messages that are not archived, "off-channel communications."

SEC Obtains Final Judgment Against Municipal Adviser Charged with Breaching Fiduciary Duty

On January 30, 2024, the SEC obtained a final judgment against Comer Capital Group, LLC and its managing partner, Brandon L. Comer, whom the SEC charged with a breach of fiduciary duty. In its complaint, the SEC alleged that Comer Capital and Comer failed to protect the interests of their client. Collectively, Comer and Comer Capital did not provide advice to its client on the qualifications of the underwriter of municipal bonds that Comer Capital recommended and upon learning that the underwriter could not find investors to buy the bonds, did not recommend a change of underwriter. Further, the SEC claimed that Comer Capital did not provide its client with adequate advice and information needed to determine if the price of the bonds were fair and reasonable, causing the client to pay half a million dollars more than necessary in interest payments over the life of the bonds. Comer Capital and Comer did not admit or deny but entered a final judgment and paid $25,000 plus prejudgment interest and paid civil penalties in the amounts of $30,000 and $20,000, respectively.