

Private Fund Managers – 2021 SEC Enforcement Results and What to Expect Next

By Joshua Newville, Partner, Proskauer*

For much of 2021, the SEC has been in transition. New Enforcement staff have been settling into their roles since April of 2021, when Gary Gensler was confirmed and sworn in as Chair of the SEC. Under former Chairman Jay Clayton, private fund advisers benefited indirectly from the SEC's focus on "Main Street" investors. More of the SEC's limited resources were devoted to addressing retail fraud, leaving fewer resources available to focus on private funds. The SEC relied more heavily on exams by the Division of Examinations – through deficiency notices and remediation – to address perceived private fund compliance violations.

On November 10, 2021, in prepared remarks before a meeting sponsored by the Institutional Limited Partners Association, Chair Gensler presented his views on private equity and hedge funds in the U.S. capital markets, and listed five areas in which he has asked the SEC staff to consider recommendations: (1) transparency of fees and expenses, (2) transparency and content of side letters, (3) transparency of performance metrics, (4) contractual waivers of fiduciary duties and conflicts of interest, and (5) potential expansions of the information reported on Form PF. If the staff's consideration of these areas results in proposed rulemakings, it could constitute a significant expansion of the SEC's regulation of private funds and their advisers (including in the ESG area).



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On November 18, 2021, the Division announced its [Enforcement Results for Fiscal Year 2021](#), and there are a few key takeaways.

- In spite of the continued headwinds posed by the global COVID-19 pandemic and the transition to new leadership, the Commission brought 697 enforcement actions in FY 2021. The Commission also filed 434 new enforcement actions, representing a seven percent increase over the prior year. Seventy percent of these new or "stand-alone" actions involved at least one individual defendant or respondent.
- Investment adviser and investment company cases accounted for 120 stand-alone actions in the past year (28% of total new cases, up from 21 percent in FY 2020).
- Insider trading cases accounted for 28 stand-alone actions, two fewer than 2020.
- The SEC also obtained judgments and orders for nearly \$2.4 billion in disgorgement and more than \$1.4 billion in penalties, which represented a respective 33 percent decrease in disgorgement but a 33 percent increase in penalties over amounts ordered in the prior fiscal year in these categories. The disgorgement numbers were likely affected by (1) the Supreme Court's June 2020 decision in *Liu v. SEC*, setting limitations on disgorgement, and (2) the completion of the [SEC's Share Class Selection Disclosure Initiative](#), which involved disgorgement-heavy settlements from FY 2019-2020.
- The Commission awarded a record amount of whistleblower awards in 2021, awarding a total of \$564 million to 108 whistleblowers. The whistleblower pro-

Continued on page 13

gram also surpassed \$1 billion in awards over the life of the program.

The Commission also highlighted its actions against individuals and gatekeepers and cases involving crypto, financial fraud and issuer disclosers, investment professionals, market integrity, insider trading and market manipulation, FCPA, public finance abuse, and securities offerings.

transportation company that plans to offer in-space infrastructure services. The SEC alleged that respondents made materially misleading statements in their public disclosures, as well as misleading statements to their investors, regarding their space technology and certain national security risks. Given the rapid growth in this sector over the past few years, the SEC's Enforcement Division has a working group focused on the

he was paid to do so. In addition, two separate actions have been announced by federal prosecutors and the CFTC against BitMEX, one of the world's biggest cryptocurrency trading exchanges. It is alleged that [BitMEX failed to limit money laundering and other illegal activities of its customers](#), despite being aware of such activities. In the same month, the Attorney General's Cyber-Digital Task Force issued the [Cryptocurrency Enforcement Framework](#), which addresses the enforcement challenges arising from the increased uptake of cryptocurrency. This is on the heels of a few years of enforcement actions, particularly those brought by the SEC for unregistered and fraudulent offerings of ICOs as well as [unregistered crypto-related funds and ICO broker-dealers](#).

These actions followed the SEC's [litigated action](#) filed in the U.S. District Court for the Southern District of New York against Ripple Labs Inc. and two of its executive officers (collectively, "Ripple"), alleging that Ripple raised over \$1.3 billion in unregistered offerings of the digital asset known as XRP. If the SEC is ultimately successful in this matter, it will be encouraged to continue to assert its jurisdiction in the space.

[Chair Gensler recently asserted](#) that many decentralized finance projects bore enough resemblance to securities that they could and should be subject to regulation by the SEC. [In the SEC's first action involving "decentralized finance" \(DeFi\) technology](#), two men and their company agreed to settle charges that they improperly offered a decentralized money market product known as DeFi Money Market ("DMM"), through which they sold over \$30 million in unregistered securities. The respondents used smart contracts to offer and sell two types of digital tokens, and the SEC ultimately found that both types of tokens offered by DMM qualified as securities because they were offered and sold as investment contracts under the *Howey* test.

Enforcement Actions Filed in Fiscal Years 2016 to 2021

	FY 2021	FY 2020	FY 2019	FY 2018	FY 2017	FY 2016
Stand-alone Enforcement Actions (Civil and AP)	434	405	526	490	446	548
Follow-On Admin. Proceedings	143	180	210	210	196	195
Delinquent Filings	120	130	126	121	112	125
Total Actions	697	715	862	821	754	868
Disgorgement and Penalties Ordered (in billions)	\$3.80	\$4.68	\$4.35	\$3.95	\$3.79	\$4.08

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SPACs

The SEC will be pursuing a number of enforcement actions involving special purpose acquisition companies ("SPACs"). For example, in July 2021, the SEC brought an [enforcement action](#) against a SPAC and its major participants based upon false statements by the SPAC target and the failure to conduct appropriate due diligence by the SPAC sponsor in the de-SPAC process. The SPAC at issue, Stable Road Acquisition Company, sought to merge with Momentus Inc., a privately-held space

area, combined with staff guidance and remarks earlier this year on SPACs relating to the use of projections, accounting methodologies and celebrity involvement with SPACs.

Digital Assets, Cryptocurrencies and Decentralized Finance

With new types of digital assets and related business on the rise, the SEC and other federal authorities have been busy investigating. Chair Gensler has made it abundantly clear that he views regulation and enforcement surrounding cryptocurrencies as a major priority.

In October 2020, multiple high-profile enforcement actions commenced. The [SEC charged businessman and computer programmer John McAfee](#) for promoting investments in ICOs to his Twitter followers without disclosing that

Continued on page 14

Similarly, a web-based trading platform known as Poloniex reached a \$10 million settlement with the SEC for operating an unregistered digital asset “exchange” in violation of the Securities Exchange Act. The Poloniex platform allowed users to buy and sell cryptocurrencies and other digital assets. The SEC order noted that even after the SEC issued the [DAO Report](#) in July 2017 (providing public guidance on digital assets as securities), Poloniex continued to be “aggressive” in approving new digital assets for trading on its platform. Because the Poloniex platform qualified as an exchange by facilitating transactions of digital asset securities, but failed to register with the SEC, the SEC found Poloniex in violation of Section 5 of the Exchange Act.

Trading Violations

The SEC continues to bring enforcement actions in connection with trading violations. In August 2021, [the SEC announced that it settled charges](#) against Murchinson Ltd., its principal, and its trader, for providing inaccurate information to a hedge fund client’s brokers on hundreds of the hedge fund’s orders. According to the [SEC order](#), the respondents led the brokers to mismark the sales as “long,” which in turn caused the brokers to violate Regulation SHO and to fail to register with the SEC.

The SEC issued an order in September 2021 stating that it had settled with Helikon, an exempt reporting adviser based in London, for violating Rule 105 of Regulation M of the Exchange Act. Specifically, the company short sold American depository shares (“ADSs”) of NIO, Inc., then purchased NIO ADSs in their public offering three days later, in violation of Rule 105’s restriction against purchasing securities in a public offering within five days of short selling those securities (with some limited exceptions that did not apply here).

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Conflicts of Interest

In September 2021, the SEC announced that it settled with investment adviser Diastole Wealth Management, Inc. and its principal for failing to disclose conflicts of interest in connection with their management of investments for a private fund client. The respondents had invested some of the private fund’s assets in a company owned and operated by the principal’s son. Among various violations of the Advisers Act, the respondents breached their fiduciary duty to the fund and its partners by failing to disclose that the fund was investing in the son’s company, and also by making material misrepresentations in connection with the same.

Valuation and Pricing

The SEC settled a novel enforcement action in December 2020 against ICE Data Pricing & Reference Data LLC (“ICE”), a pricing service that supplies data to investment managers. The SEC found that from 2015 through 2020, instead of seeking multiple data points, ICE relied upon a single broker quote to determine the prices of certain fixed income securities, making it difficult for ICE clients to ascertain the reliability of the data. The SEC found that ICE failed to develop written compliance policies and procedures that addressed the reliability of single broker quotes, resulting

in price quotes that may not have been “a reasonable reflection of the security’s value.” In settlement, the SEC found violations of the compliance rule.

Fraud and Misleading Disclosures

On February 4, 2021, the SEC announced that it settled with the chief investment officer of International Investment Group, LLC (“IIG”), who allegedly concealed hedge fund portfolio losses by taking certain defaulted loans and inflating their value or replacing them with fake loans, then selling them to advisory clients. The defendant had previously pleaded guilty in federal court to counts of securities fraud, wire fraud, and conspiracy to commit several types of fraud.

In March 2021, the SEC settled another fraud-related proceeding with principals of the Foundry Capital Group, a state-registered investment adviser that managed the Foundry Mezzanine Opportunity Fund (the “Fund”), finding that they had violated various securities laws by making misrepresentations to clients and failing to disclose conflicts of interest. Specifically, the SEC found that the principals sent, and/or reviewed newsletters to investors containing misstatements and omissions about the “struggling” financial status of companies receiving loans from the Fund. The SEC order additionally found that one respondent had made misrepresentations to investors regarding the valuations of Fund holdings, representing that he would get independent valuations but instead valuing them at cost. The order against a principal who was an investment adviser representative found that he failed to disclose to his advisory clients the conflict of interest created by the fact that he had sold them interests in the Fund in which he also had financial interests.

In August 2021, the SEC settled with McDonald Partners LLC for failure to disclose to investors in pooled investment vehicles it managed that it knew

Continued on page 15

of allegations that investor funds were being misappropriated and used to pay for personal expenses through a debit card. The respondent not only failed to disclose the misappropriation to existing investors, but it continued to raise funds from new investors without disclosing the misappropriation to them, either. The respondent further failed to provide investors in the pooled investment vehicle with audited financial statements or to have an independent public accountant examine the books of the entities involved in the misappropriation. As a result, the SEC found the respondent had violated various antifraud provisions of the federal securities laws.

In another action focusing on fraudulent disclosures, the SEC charged the former principals of TCA Fund Management Group Corp., an advisory firm, in September 2021 for contributing to the firm's "scheme to artificially inflate the net asset values and performance results" of several funds managed by the firm. This case arose out of a previously-settled administrative action against

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the former COO and CFO of TCA for the same fraudulent scheme. The relevant orders issued in September 2021 found that the principals caused TCA to inflate net asset values and TCA fund performance by recording in their books non-binding transactions and fraudulent fees, and by including false values and exaggerated performance results in promotional materials.

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views as encompassing private equity and hedge funds, private fund managers should expect enhanced levels of enforcement activity in the coming years.

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