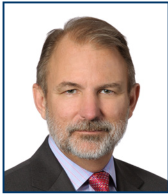
Blurring Lines: Examination Priorities and Enforcement Risk

Wednesday, March 23, 2016

1. About the Speaker
2. Navigating Risks in the New Enforcement Environment
3. Recent Examinations: Substantive Areas of Regulatory Focus
4. Trading Compliance: Managing Regulatory Risk

Schulte Roth & Zabel

About the Speaker



Charles J. Clark
Partner
Schulte Roth & Zabel
+1 202.729.7480 | +1 212.756.2046
charles.clark@srz.com

Charles J. Clark is a partner with Schulte Roth & Zabel, where he represents financial institutions, public companies and accounting firms, and their senior executives, in securities-related enforcement proceedings before the SEC, DOJ, FINRA, CFPB, and other federal and state law enforcement and regulatory authorities. In particular, he counsels hedge funds, private equity firms, venture capital funds and other asset managers through regulatory scrutiny, including in routine and risk-based inspections and examinations and in enforcement proceedings. He defends investigations involving a broad spectrum of issues, including accounting and disclosure fraud, insider trading, foreign corruption, offering fraud, market manipulation, breach of fiduciary duty and conflicts of interest. In addition, Charles represents boards of directors and associated committees in internal investigations, and he provides guidance on corporate governance and trading practices for public companies and private funds. Prior to entering private practice, Charles served for nine years in the SEC's Division of Enforcement, most recently as assistant director supervising the investigation and prosecution of some of the SEC's most significant matters, including its investigation of Enron Corporation. He was the recipient of several awards from the SEC, including the SEC Chairman's Award and the SEC Law and Policy Award.

A frequent speaker and panelist, Charles has addressed a wide variety of topics of interest to the white collar defense community, including, recent regulatory challenges for private investment funds, cybersecurity regulatory issues, the Wells settlement process at the SEC and short-selling violations under Rule 105. He also serves as a resource for numerous media publications, including *Bloomberg News*, *Financial Times*, *The Wall Street Journal* and *The Washington Post*.

Charles holds a J.D. from the New York University School of Law and a B.A., with high distinction, from the University of Virginia.

© 2016 Schulte Roth & Zabel LLP

Navigating Risks in the New Enforcement Environment

Navigating Risks in the New Enforcement Environment

I. Inter-Relationship Between SEC Examinations and Enforcement Actions, As Well As Between Civil and Criminal Liability

A. Cooperation Between the Securities and Exchange Commission's Office of Compliance Inspections and Examinations ("OCIE") and the Enforcement Division: Following the investigation and prosecution of Bernard Madoff's $17.3-billion Ponzi scheme, the SEC modified the National Exam Program ("NEP") run by OCIE.

1. This has led to increased cooperation between OCIE and staff members from the Division of Enforcement when conducting inspections and examinations, as well as an increase in enforcement actions resulting from OCIE examinations.

2. As a result of this increased cooperation, more and more OCIE examinations include someone from the Enforcement Division as part of the staff conducting an OCIE examination. The mere fact that members of the Enforcement Division participate in a firm's examination does not necessarily mean that the examination will result in a referral to the Enforcement Division, but it does increase the possibility that that will happen.

3. The SEC's approach to enforcement has been increasingly aggressive. After a record-breaking 2014 in which the SEC filed 755 enforcement actions and recovered $4.16 billion in disgorgement and penalties, the Commission managed to go even further the following year, bringing 807 enforcement actions and recovering approximately $4.19 billion by the end of fiscal year 2015.

4. Particularly for hedge funds and private equity funds, since the creation of the Enforcement Division's Asset Management Unit, there has been an emphasis on increasing examiner expertise in those industries,[1] and OCIE has increased its focus on investment advisers of all varieties.[2]

5. Fund managers need to be prepared and should expect that their policies, procedures and practices will be scrutinized carefully during OCIE examinations.[3]

6. Increased cooperation between OCIE and the Division of Enforcement has meant that violations that may have previously been ignored as immaterial may now result in deficiency letters and that matters which previously were the subject of deficiency letters might result in an investigation by the Enforcement Division and/or an enforcement action.

B. Potential Exposure to Criminal Liability/Cooperation Between the SEC and Criminal Prosecutors

1. Regulators have adopted increasingly prosecutorial mindsets in an effort to drive their respective Enforcement Divisions in a more aggressive direction. This has been accomplished by hiring an increased number of former prosecutors into enforcement roles.[4]

---

[1] Hazel Bradford, "SEC Management Enforcement Unit Evolves into Respected Watchdog," *Pensions & Investments* (Nov. 30, 2015), *available at* www.pionline.com/article/20151130/PRINT/311309984/sec-management-enforcement-unit-evolves-into-respected-watchdog.

[2] National Examination Program: Office of Compliance Inspections and Examination, *Examination Priorities for 2015*, Securities and Exchange Commission (2015).

[3] Marc E. Elovitz, "SEC Examinations of Private Fund Advisers," *The Review of Securities & Commodities Regulation* (June 17, 2015), *available at* www.srz.com/files/News/4d8f612d-6b91-4ce0-9fa3-fa16b9d51770/Presentation/NewsAttachment/f29ce315-5f8c-44e2-b7bf-006192c396e8/The_Review_of_Securities_and_Commodities_Regulation_SEC_Examinations_of_Private_Fund_Advisers_Jul.pdf.

© 2016 Schulte Roth & Zabel LLP

2. The current Directors of Enforcement at both the SEC and the CFTC are former federal prosecutors, and an increasing number of senior enforcement lawyers at both agencies have backgrounds as criminal prosecutors.

3. Increasingly, financial regulators and prosecutors are cooperating with each other for the purpose of building stronger cases against white collar defendants. The Department of Justice notes that as many cases now feature parallel proceedings (criminal and regulatory) and/or the presence of multi-agency task forces, prosecution teams have expanded accordingly to facilitate cooperation with these regulators.[5]

4. These developments force potential defendants to reconsider whether to cooperate with regulators in exchange for reduced penalties, as such cooperation can lead to eventual criminal charges down the road.

II. Enforcement by the CFTC and Commodities and Futures Exchanges

A. Enforcement by the CFTC

1. The CFTC brought 69 enforcement actions and collected $3.14 billion in civil penalties in fiscal year 2015. This is the largest amount the CFTC has collected in its history and is not far behind the amount collected by the much larger SEC.[6]

2. The CFTC has adopted a more aggressively prosecutorial stance, bringing in a former federal prosecutor to serve as head of its Enforcement Division last year.[7]

B. Recent Major Enforcement of Commodities Laws and Regulations

1. Michael Coscia: Coscia was prosecuted criminally and convicted for entering orders that he had no intention to execute (i.e., spoofing) for the purpose of impacting commodities prices. Coscia took advantage of these price fluctuations in order to generate a profit; using this strategy he earned $1.4 million in less than three months.[8] This case was jointly investigated and litigated by the U.S. Attorney's Office and the CFTC.

2. Navinder Singh Sarao and Nav Sarao Futures Limited PLC: The CFTC has charged Sarao and his firm with spoofing and unlawful manipulation of commodities markets. According to the CFTC's complaint, Sarao's firm was layering large sell orders at different price levels, ensuring that they were seen by other traders, and then canceling the trades. The CFTC is seeking disgorgement, civil penalties, and a trading suspension or ban against Sarao.[9]

---

[4] Aruna Viswanatha and Christopher Matthews, "Regulators Tap Prosecutors for Key Jobs," *The Wall Street Journal* (April 6, 2015), *available at* www.wsj.com/articles/regulators-tap-prosecutors-for-key-jobs-1428361038.

[5] David Ogden, *Guidance for Prosecutors Regarding Criminal Discovery*, Department of Justice (Jan. 4, 2010), *available at* www.justice.gov/dag/memorandum-department-prosecutors.

[6] Press Release, Commodities Futures Trading Commission, CFTC Releases Annual Enforcement Results for Fiscal Year 2015 (Nov. 6, 2015), *available at* www.cftc.gov/PressRoom/PressReleases/pr7274-15.

[7] Ben Protess, "Commodities Regulator Names New Enforcement Chief," *The New York Times* (June 10, 2014), *available at* http://dealbook.nytimes.com/2014/06/10/c-f-t-c-hires-new-enforcement-director/?_r=0.

[8] "US High Frequency Trader Convicted in First US Spoofing Case," *The Guardian* (Nov. 4, 2015), *available at* www.theguardian.com/us-news/2015/nov/04/us-high-frequency-trader-convicted-first-spoofing-case-michael-coscia.

[9] Press Release, Commodity Futures Trading Commission, CFTC Charges U.K. Resident Navinder Singh Sarao and His Company Nav Sarao Futures Limited PLC with Price Manipulation and Spoofing (April 21, 2015), *available at* www.cftc.gov/PressRoom/PressReleases/pr7156-15.

© 2016 Schulte Roth & Zabel LLP

3. Arya Motazedi: In the first-ever insider-trading case brought by the CFTC, the Commission found that Motazedi had misappropriated material, nonpublic information for the purpose of making fraudulent transactions between his employer and an account he owned. These trades, which involved oil and gas futures, were designed to generate profits for himself and losses for his employer.[10]

C. Enforcement by Commodities and Futures Exchanges

1. Between April 1, 2012 and March 31, 2013 (the last period reviewed by the CFTC), the Commodities and Futures Exchanges (which include the Chicago Board of Trade (CBOT), Chicago Mercantile Exchange (CME), the Commodity Exchange, Inc. (COMEX) and the New York Mercantile Exchange (NYMEX), collectively referred to as "the Exchanges") brought 93 enforcement actions in their capacity as self-regulatory organizations ("SROs").[11]

   (a) During this period, the Exchanges assessed a total of $6.3 million in fines (ranging from $5,000 to $1 million), and $2,023,900 in disgorgement (ranging from $6,000 to $1.1 million).[12]

   (b) Additionally, the Exchanges issued suspensions for 51 individuals (ranging from five days to 25 years), and imposed permanent bars on membership against 10 respondents.[13]

   (c) The Exchanges have focused their enforcement efforts on highly technical rule violations:

      (i) Exchange for Related Positions ("EFRP"): EFRP transactions allow investors to exchange futures contracts for their related physical instruments, derivative positions or options (or other OTC contracts with similar characteristics).[14]

         (1) The rules governing the circumstances in which EFRPs are permissible are highly technical and have recently been the focus of regulatory action by the Exchanges. The Exchanges often refer to these rules as essentially imposing strict liability.

         (2) Toronto Dominion Bank ("TD"): In a settlement between TD and NYMEX, TD neither admitted nor denied a violation of NYMEX Rule 538.C.[15] TD was alleged to have entered into an EFRP which did not involve the transfer of the cash commodity underlying the Exchange contract, or a by-product, related product or OTC instrument, between TD and its counterparty.[16] TD paid a fine of $15,000.[17]

---

[10] Arya Motazedi, CFTC Docket No. 16-02 (Dec. 2, 2015).

[11] U.S. Commodities Futures Trading Commission, Division of Market Oversight, *Disciplinary Program Rule Enforcement Review of the CBOT, CME, COMEX, and NYMEX* (Nov. 21, 2014), *available at* www.cftc.gov/idc/groups/public/@iodcms/documents/file/rerdisciplinaryprogram112114.pdf.

[12] *Id.*

[13] *Id.*

[14] CME Group, *Exchange for Related Positions ("EFRPs")*, *available at* www.cmegroup.com/clearing/trading-practices/efp-efr-eoo-trades.html.

[15] Notice of Disciplinary Action – Toronto Dominion Bank, NYMEX 15-0130-BC-2 (Nov. 25, 2015), *available at* www.cmegroup.com/tools-information/lookups/advisories/disciplinary/NYMEX-15-0130-BC-2-TORONTO-DOMINION-BANK.html.

[16] *Id.*

[17] *Id.*

© 2016 Schulte Roth & Zabel LLP

(ii) Position Limit Violations: CME Rule 562 stipulates, "Any positions … in excess of those permitted under the rules of the Exchange shall be deemed position limit violations."[18]

Pacific Investment Management Company LLC ("PIMCO"): In a settlement agreement between PIMCO and CBOT, PIMCO neither admitted nor denied a violation of CBOT Rule 562.[19] PIMCO was alleged to have violated Rule 562 by having held end-of-day net short positions in excess of both single-month and all-month position limits.[20] PIMCO paid a fine of $35,000.[21]

(d) The CFTC's most recent review found that the Exchanges' practice of sending warning letters was effective for the purpose of deterring violations and that the Exchanges had a reasonable basis for bringing all 93 of the enforcement actions that they filed. However, the CFTC also found that staffing shortages at the Exchanges led to several matters not being enforced promptly.[22]

III. Conflicts of Interest: Recent Enforcement Actions

A. BlackRock Advisors LLC (April 2015)

1. In a settlement with the SEC, BlackRock agreed to pay $12 million and to engage an independent compliance consultant to conduct an internal review for failing to disclose a conflict of interest created by the outside business activity of a top-performing portfolio manager.[23]

2. According to the SEC, the portfolio manager at issue was also the founder of, and a general partner and investor (in the sum of approximately $50 million) in an outside fund participating in a joint venture that eventually became the largest holding in a BlackRock fund.[24]

3. Also according to the SEC, BlackRock knew and approved the portfolio manager's investment and involvement with Rice Energy as well as the joint venture, but failed to disclose the conflict of interest to either the boards of the BlackRock registered funds or its advisory clients.

4. Significantly, BlackRock's then-chief compliance officer ("CCO") agreed to pay a $60,000 penalty to settle the charges against him, which included failure to report a material compliance matter to the funds' boards of directors and causing a failure to adopt and implement policies and procedures for outside activities of employees.[25]

B. Guggenheim Partners Investment Management LLC (August 2015)

1. Guggenheim paid $20 million to the SEC to settle, among other things, charges that it breached its fiduciary duty to disclose a $50-million loan that one of its senior executives received from an

---

[18] CME Rulebook, *562. Position Limit Violations*, *available at* www.cmegroup.com/rulebook/CME/I/5/5.pdf.

[19] Notice of Disciplinary Action – Pacific Investment Management Company LLC, CBOT 14-0035-BC (July 24, 2015), *available at* www.cmegroup.com/tools-information/lookups/advisories/disciplinary/CBOT-14-0035-BC-PACIFI-INVESTMENT-MANAGEMENT-COMPANY-LLC.html.

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] BlackRock Advisors, LLC and Bartholomew A. Battista, Investment Advisers Act Release No. 4065 (April 20, 2015).

[24] *Id.*

[25] *Id.*

© 2016 Schulte Roth & Zabel LLP

advisory client, which the SEC alleged created a potential conflict of interest that might cause Guggenheim to place that client's interests over those of other clients.[26]

2. According to the SEC, after the executive received the loan, the executive then facilitated the investment by the client that issued the loan to him into certain transactions. Later, the same executive facilitated an investment into the same transactions by other Guggenheim clients, which received different terms than the client that had made the loan had received.[27]

3. On these facts, the SEC alleged, among other things, that the failure to disclose the existence of the loan to its other clients was a breach of Guggenheim's fiduciary duties to its clients.[28]

C. JP Morgan Chase Bank N.A. and J.P. Morgan Securities LLC (December 2015)

1. JP Morgan Chase Bank N.A. and J.P. Morgan Securities LLC ("JPM") agreed to pay a total of $307 million to settle charges by the SEC[29] and CFTC[30] that JPM failed to disclose conflicts of interest relating to preferences for (i) JP Morgan-managed mutual funds, (ii) JP Morgan-managed private hedge funds, and (iii) third-party-managed private hedge funds that shared client fees with a JP Morgan affiliate.

2. As part of the settlement, JPM paid $267 million to the SEC[31] and $40 million to the CFTC[32] and had to admit the SEC's factual allegations.

IV. Expense and Fee Allocations

A. "By far the most common deficiencies noted by our examiners in private equity relate to expenses and expense allocation. Many managers still seem to take the position that if investors have not yet discovered and objected to their expense allocation methodology, then it must be legitimate and consistent with their fiduciary duty ... . This practice can be difficult for investors to detect but easy for our examiners to test," said Marc Wyatt, director of OCIE.[33]

B. Kohlberg Kravis Robert & Co. ("KKR"): The SEC entered into a settlement with KKR, alleging that KKR charged its clients approximately $338 million in fees over a six-year period related to broken deal or diligence expenses.[34]

1. The SEC alleged that KKR had not been allocating these expenses to co-investors (including some of the firm's executives) and had failed to disclose this practice.[35]

2. KKR agreed to pay over $14 million in disgorgement and a $10-million penalty.[36]

---

[26] Guggenheim Partners Investment Management, LLC, Investment Advisers Act of 1940 Release No. 4163 (Aug. 10, 2015).

[27] *Id.*

[28] *Id.*

[29] JPMorgan Chase Bank, N.A. and J.P. Morgan Securities LLC, Investment Advisers Act of 1940 Release No. 4295 (Dec. 18, 2015).

[30] JPMorgan Chase Bank, N.A., CFTC Docket No. 16-05 (Dec. 18, 2015).

[31] JPMorgan Chase Bank, N.A. and J.P. Morgan Securities LLC, Investment Advisers Act of 1940 Release No. 4295 (Dec. 18, 2015).

[32] JPMorgan Chase Bank, N.A., CFTC Docket No. 16-05 (Dec. 18, 2015).

[33] Securities and Exchange Commission, Private Equity: A Look Back and a Glimpse Ahead (May 13, 2015), *available at* www.sec.gov/news/speech/private-equity-look-back-and-glimpse-ahead.html.

[34] Securities and Exchange Commission, SEC Charges KKR with Misallocating Broken Deal Expenses, Release No. 2015-131 (2015).

[35] *Id.*

© 2016 Schulte Roth & Zabel LLP

3. "This is the first SEC case to charge a private equity adviser with misallocating broken deal expenses," said Andrew Ceresney, director of the SEC Division of Enforcement.[37]

C. The Blackstone Group: The SEC charged Blackstone with failing to disclose the acceleration of monitoring fees paid by fund-owned portfolio companies prior to their sale or initial public offering. The SEC alleged that these accelerating fees had the effect of reducing the value of the portfolio companies prior to their sale.[38] The SEC's investigation also found that Blackstone had failed to disclose to investors the existence of a separate fee arrangement with an outside law firm that provided Blackstone with a much greater discount than the same law firm provided to the relevant funds.[39]

1. Blackstone agreed to pay over $26 million in disgorgement and a $10-million penalty in order to settle the charges.[40]

2. "Full transparency of fees and conflicts of interest is critical in the private equity industry and we will continue taking action against advisers that do not adequately disclose their fees and expenses, as Blackstone did here," said Andrew Ceresney, director of the SEC Division of Enforcement.[41]

V. Individual Responsibility

A. Chief Compliance Officer Liability

1. In a series of recent actions, the SEC has sought to hold CCOs liable for compliance failures at their firms. This has caused concern — including a public dissent from approval of two settlements by an SEC Commissioner who subsequently left the Commission[42] — as the claim in these cases is that the CCO failed to implement an effective compliance program despite the fact that the relevant SEC Rule places that obligation to "implement" an effective compliance program on the investment adviser and not on the CCO.[43]

2. Recent Enforcement Actions Against CCOs

(a) BlackRock Advisors Inc. and Bartholomew Battista

(i) One of BlackRock's portfolio managers was also engaged in managing an outside fund. This fund engaged in a joint venture, which BlackRock then had several clients invest in without disclosing the interest that its portfolio manager had in the venture.[44]

(ii) The SEC alleged that this conflict of interest occurred because BlackRock failed to have adequate compliance policies in place, and that Bartholomew Battista, its CCO, was

---

[36] *Id.*

[37] *Id.*

[38] Securities and Exchange Commission, Blackstone Charged with Disclosure Failures, Release No. 2015-235 (2015).

[39] *Id.*

[40] *Id.*

[41] *Id.*

[42] Commissioner Daniel M. Gallagher, Securities and Exchange Commission, Statement on Recent SEC Settlements Charging Chief Compliance Officers with Violations of Investment Advisers Act Rule 206(4)-7 (June 18, 2015), *available at* www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html.

[43] Ben DiPietro, "SEC Actions Stir Concerns over Compliance Officer Liability," *The Wall Street Journal* (June 24, 2015), *available at* http://blogs.wsj.com/riskandcompliance/2015/06/24/sec-actions-stir-concerns-over-compliance-officer-liability/.

[44] BlackRock Advisors, LLC and Bartholomew A. Battista, Investment Advisers Act Release No. 4065 (April 20, 2015).

© 2016 Schulte Roth & Zabel LLP

responsible for this failure. The Commission's view was driven by the fact that Battista knew about the outside activity of several BlackRock managers and still allegedly failed to implement compliance policies designed to monitor and disclose this activity.[45]

(iii) Part of the SEC's criticism of Battista was a claim that BlackRock's compliance procedures were too generic and were not specifically tailored to the actual conflict that arose.

(b) SFX Financial Management Enterprises Inc. and Eugene Mason

(i) An SFX executive was found to have misappropriated client funds by writing checks from their bank accounts to himself over a period of eight years, during which he served as a vice president of SFX and then as its president. When SFX's CCO, Eugene Mason, discovered this, the firm hired outside counsel, conducted an internal investigation, terminated the firm's then-president and reported his misconduct to prosecutors. SFX then cooperated in the ensuing criminal prosecution of its former president.[46]

(ii) In spite of efforts by SFX, and Mason in his capacity as CCO, to work with criminal authorities, the SEC alleged that Mason was responsible for the implementation of SFX's policies and procedures and had failed in this task.[47] Specifically, the Commission alleged that Mason did not effectively implement a provision of SFX's compliance policy providing for the review of cash flows in client accounts; the SEC viewed this as particularly troubling because SFX's Form ADV stipulated that such review was to be done by senior management.[48] The SEC was also troubled by what it alleged was Mason's failure to conduct an annual review of SFX's compliance program (in spite of the fact that this review was delayed because SFX, and Mason particularly, were actively involved in an internal investigation relating to the misappropriation at issue).[49]

(c) In a noteworthy written dissent regarding both the BlackRock and SFX settlements, SEC Commissioner Daniel Gallagher (who resigned from the Commission towards the end of last year) expressed concern that the SEC had effectively taken the position that CCOs are strictly liable for the failure to implement their firms' compliance policies and procedures.[50]

(i) Commissioner Gallagher was concerned that these recent settlements were "undoubtedly sending a troubling message that CCOs should not take ownership of their firm's compliance policies and procedures, lest they be held accountable for conduct that, under Rule 206(4)-7, is the responsibility of the adviser itself. Or worse, that CCOs should opt for less comprehensive policies and procedures with fewer specified compliance duties and responsibilities to avoid liability when the government plays Monday morning quarterback."[51]

---

[45] *Id.*

[46] SFX Financial Advisory Management Enterprises, Inc. and Eugene S. Mason, Investment Advisers Act Release No. 4116 (June 15, 2015).

[47] *Id.*

[48] *Id.*

[49] *Id.*

[50] Commissioner Daniel M. Gallagher, Securities and Exchange Commission, Statement on Recent SEC Settlements Charging Chief Compliance Officers with Violations of Investment Advisers Act Rule 206(4)-7 (June 18, 2015), *available at* www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html.

[51] *Id.*

© 2016 Schulte Roth & Zabel LLP

(ii) In response, the SEC has sought to reassure the compliance community in the wake of these cases, noting that it continues to bring an extremely small number of enforcement actions against CCOs and that the vast majority of these cases involve CCOs who "wore more than one hat," or were otherwise personally involved in the misconduct.[52]

(d) Sands Brothers Asset Management LLC and Christopher Kelly

(i) In October 2014, the SEC instituted cease-and-desist proceedings against Sands Brothers and its CCO, Christopher Kelly, for an alleged violation of Section 206(4)-2 of the Advisers Act and Rule 206(4)-2 thereunder.[53]

(ii) Sands Brothers had consented to a settlement of cease-and-desist proceedings brought against the firm in 2010 related to an earlier alleged violation of Rule 206(4)-2.[54] The SEC alleged that the firm had continued to fail to comply with the rule by failing to distribute audited financial statements to 10 funds within a 120-day window, imposed by the rule, at the end of each fiscal year.[55]

(iii) The SEC further alleged that Kelly, as CCO (but also serving as chief operating officer and as a partner of Sands Brothers), knew or was reckless in not knowing of, and substantially assisted, Sands Brothers' violations of Rule 206(4)-2. As such, the SEC alleged that Kelly had willfully aided and abetted Sands Brothers' in its alleged violations of Section 206(4)-2 and Rule 206(4)-2.[56]

(iv) While acknowledging that Kelly "reminded people of the custody rule deadline,"[57] the SEC alleged that more substantial action was required of Kelly as CCO. Specifically, the SEC alleged that because Sands Brothers' compliance manual tasked Kelly with "ensuring compliance with … Rule 206(4)-2," and because such compliance was not occurring, Kelly had failed to implement policies or procedures to ensure compliance with the rule.[58]

B. The Yates Memo

1. This memo broadly outlines the intent of the DOJ to increase its focus on bringing criminal charges against individuals bearing responsibility for corporate misconduct.[59]

   The memo makes clear that its guidance should also be taken into consideration by regulators responsible for bringing civil actions in response to allegations of corporate misconduct, but the memo only applies to the DOJ and not to the SEC, CFTC or other regulators.[60]

---

[52] Commissioner Luis A. Aguilar, Securities and Exchange Commission, The Role of Chief Compliance Officers Must Be Supported (June 29, 2015), *available at* www.sec.gov/news/statement/supporting-role-of-chief-compliance-officers.html. Like Commissioner Gallagher, Commissioner Aguilar also resigned from the Commission at the end of last year.

[53] Sands Brothers Asset Management, LLC, Steven Sands, Martin Sands, and Christopher Kelly, Investment Advisers Act Release No. 3960 (Oct. 29, 2014).

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.*

[58] *Id.*

[59] Sally Quillian Yates, Department of Justice, *Individual Accountability for Corporate Wrongdoing* (Sept. 9, 2015).

[60] *Id.* at 2-3, 6.

© 2016 Schulte Roth & Zabel LLP

2. Recommendations for Corporations

(a) Provide all relevant facts regarding individual involvement in corporate misconduct.[61] The Yates memo takes the position that corporations must turn over absolutely all evidence related to individual misconduct, and corporations may not pick and choose what to turn over, before they will be considered for any kind of cooperation credit.

(b) Focus on individual wrongdoing from the outset of an investigation.

(c) Increase cooperation between criminal and civil attorneys. The goal is that increased dialogue between criminal and civil government attorneys would lead to more thorough investigations and a full range of potentially viable claims being brought against alleged wrongdoers.[62]

(d) Settlements with corporations should not release alleged individual wrongdoers from liability.[63]

(e) Always resolve cases of corporate misconduct with a plan to deal with allegedly culpable individuals before the relevant statute of limitations expires.

(f) Civil attorneys for the government should also focus on individuals and look beyond a party's ability to pay a judgment when considering whether to bring suit.[64]

VI. Insider Trading Post-*Newman*

A. Significance of *U.S. v. Newman*

1. In *Newman*, the U.S. Court of Appeals for the Second Circuit reversed two insider-trading convictions, finding that the government had not sufficiently proved that the defendants had been aware that the insiders responsible for passing on information had done so in exchange for a personal benefit and thus in violation of their fiduciary duties.[65]

2. The *Newman* court also held that the government had failed to adequately prove that the insiders obtained a personal benefit that was sufficiently concrete and of a pecuniary or pecuniary-like nature, finding that such a benefit is an essential element of a breach of fiduciary duty by the insider necessary to give rise to insider-trading liability.[66]

(a) The government had argued that the receipt of career advice by the tipper qualified as a personal benefit given in exchange for the tip at issue, but the Second Circuit rejected that this was sufficient to allow a rational fact finder to conclude beyond a reasonable doubt that a personal benefit that was sufficiently concrete and pecuniary in nature had been given in exchange for the tip.[67]

---

[61] *Id.* at 3.

[62] *Id.* at 4-5.

[63] *Id.* at 5.

[64] *Id.* at 6-7.

[65] *United States v. Newman*, 773 F.3d 438, 450-51 (2nd Cir. 2014).

[66] *Id.* at 452-53.

[67] *Id.* at 452.

© 2016 Schulte Roth & Zabel LLP

(b) In rejecting the government's argument, the Second Circuit held: "To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee's trades 'resemble trading by the insider himself followed by a gift of the profits to the recipient,' … we hold that such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[68]

(c) The court did not clarify what types of personal benefit would satisfy this test, leaving it to future case-by-case evaluation by the courts. It did note, however, that entrance to an investment club, receiving client referrals, or entering into commission-splitting arrangements in exchange for a tip would suffice.[69]

B. Insider-Trading Decisions after *Newman*

1. It must be emphasized that *Newman*'s reach is limited to the Second Circuit (which consists of federal courts sitting in New York, Connecticut and Vermont). Several courts outside the Second Circuit have already decided not to follow *Newman*.

(a) *U.S. v. Salman*: The Ninth Circuit declined to follow *Newman*, holding that the U.S. Supreme Court's insider-trading jurisprudence had established that liability for a tippee could be established when an "insider makes a gift of confidential information to a trading relative or friend."[70]

(i) Of particular importance in *Salman* was the close familial relationship between the tipper and tippee (they were brothers); the tipper testified that he had given his brother information in order to "benefit him" and to "fulfill whatever needs he had."[71] In one instance, the tipper gave the tippee information in lieu of a loan.[72]

(ii) The defendant in *Salman* was the brother-in-law of the tipper and tippee, and the court found that he was aware of both the source of the tip as well as the close fraternal relationship between the tipper and tippee.[73]

(b) *U.S. v. Melvin*: A Georgia federal district court declined to follow *Newman*, noting that it was not binding authority. In rejecting the holding of *Newman*, the *Melvin* court focused on both the gift language of the U.S. Supreme Court's decision in *Dirks* in addition to the fact that pecuniary gain is not necessary to prove a personal benefit.[74]

(i) The *Melvin* court found that the defendant had a close personal friendship with those to whom he had provided confidential inside information.[75]

---

[68] *Id.*

[69] *Id.* at 453-54.

[70] 792 F.3d 1087, 1093-94 (9th Cir. 2015) (citing *Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

[71] *Id.* at 1089.

[72] *Id.*

[73] *Id.* at 1090.

[74] 2015 WL 7077258, at *15 (N.D. Ga. 2015).

[75] *Id.* at *1.

 © 2016 Schulte Roth & Zabel LLP

(ii) Important to the court's analysis was that the U.S. Court of Appeals for the Eleventh Circuit "has interpreted [*Dirks*] to define '"benefit" in very expansive terms,' indicating that in *Dirks*, 'the Court declared that not only does an actual pecuniary gain, such as a kickback or an expectation of a reciprocal tip in the future, suffice to create a "benefit," but also cases where the tipper sought to enhance his reputation (which would translate into future earnings) or to make a gift to a trading relative or friend.'"[76]

(c) It is also worth noting that the SEC's own administrative courts — in which the SEC has brought an increasing number of enforcement actions in recent years — are not bound by *Newman*.

VII. Anti-Money Laundering Rules, Cases and Implications for Fund Managers

A. Proposed FinCEN Rulemaking

1. On Sept. 1, 2015, the Financial Crimes Enforcement Network ("FinCEN") issued a notice of proposed rulemaking to prescribe, among other things, minimum standards for anti-money laundering ("AML") programs to be established by registered investment advisers. The proposed rule would also require the registered investment advisers to report suspicious transactions that are conducted or attempted by, at or through an investment adviser, and involve or aggregate at least $5,000 in funds or assets.[77]

(a) The proposed rule would apply to investment advisers who are registered or required to be registered with the SEC.

(b) AML programs must include:

(i) Development of internal policies, procedures and controls reasonably designed to prevent the investment adviser from being used for money laundering or the financing of terrorist activities, and to achieve and monitor compliance with the BSA and FinCEN's implementing regulations.

(ii) The designation of an AML compliance officer. This person should be an officer of the investment adviser.

(iii) An ongoing employee training program.

(iv) An independent audit function to test the programs.

(c) Under the proposed rule, investment advisers may contractually delegate some duties of their compliance program to other entities, including agents or third-party service providers, such as administrators. However, any entity that does so will remain fully responsible for the effectiveness of the program, as well as for ensuring that FinCEN and the SEC are able to obtain information and records relating to the AML program.

(d) The SEC will act as the designated examiner of investment advisers for compliance with the rules.

---

[76] *Id.* at *15 (quoting *SEC v. Yun*, 327 F.3d 1263, 1276 (11th Cir. 2003)).

[77] Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, 80 Fed. Reg. 169 (proposed Sept. 1, 2015) (to be codified at 31 C.F.R. Ch. X).

 © 2016 Schulte Roth & Zabel LLP

B. Recent AML Enforcement Actions

1. Oppenheimer (January 2015)

(a) The SEC charged Oppenheimer with, among other things, aiding and abetting illegal unregistered broker-dealer activity by a customer, an off-shore broker-dealer.

(b) According to the settlement document, Oppenheimer knew, suspected or had reason to suspect that one of its clients was using its Oppenheimer account to facilitate unlawful activity, but did not file Suspicious Activity Reports ("SARs").

(c) Oppenheimer agreed to admit wrongdoing and pay $10 million to settle the SEC's charges[78] and an additional $10 million to settle a parallel action by FinCEN.[79] Oppenheimer also agreed to retain an independent compliance consultant.

2. First National Community Bank (February 2015)

(a) FinCEN assessed a civil money penalty against First National Community Bank ("FNCB") for violations of the Bank Secrecy Act ("BSA"), and FNCB admitted such violations.

(b) According to the Assessment of Civil Money Penalty, FNCB failed to "detect or adequately report suspicious transactions involving millions of dollars in illicit proceeds from a judicial corruption scheme perpetrated by a former Pennsylvania state judge, among others."[80]

(c) FNCB agreed to pay a penalty of $1.5 million, of which $500,000 was concurrent with a penalty imposed by the Office of the Comptroller of the Currency. In connection with the settlement, FinCEN expressly reserved the right to bring claims against parties other than FNCB, including any current or former partner, director, officer or employee of FNCB.[81]

3. Commerzbank (March 2015)

(a) Commerzbank entered into a Deferred Prosecution Agreement with the DOJ, as well as settlements with OFAC and the Federal Reserve.[82] Commerzbank paid $563 million in disgorgement and $79 million in penalties.[83] It paid $300 million in forfeiture in connection with BSA violations. In total, Commerzbank agreed to pay a total of $1.45 billion in penalties.

(b) The DOJ alleged that one of its clients used Commerzbank to perpetuate a massive accounting fraud designed to conceal from the clients' auditors and investors hundreds of millions of dollars in losses from the late 1990s to 2011, and that Commerzbank had failed to thoroughly conduct investigations of transactions that triggered alerts in the bank's automated AML software. Moreover, the bank failed to report this suspicious activity to regulators and failed to monitor billions of dollars in correspondent banking transactions.[84]

---

[78] Oppenheimer & Co. Inc., Securities Act Release No. 9711 (Jan. 27, 2015).

[79] Oppenheimer & Co., Inc., FinCEN No. 2015-01 (Jan. 26, 2015).

[80] First National Community Bank Dunmore Pennsylvania, FinCEN No. 2015-03 at *2 (Feb. 27, 2015).

[81] *Id.*

[82] *United States v. Commerzbank*, Deferred Prosecution Agreement (March 11, 2015).

[83] *Id.*

[84] *Id.*

 © 2016 Schulte Roth & Zabel LLP

(c) Recent actions to enforce AML laws and regulations make it clear that simply having a compliance program in place is not sufficient. Among other things, regulators expect firms to have procedures in place that take into account the particular risks presented by the firm's business activities, and to have qualified AML officers. It is likely that investment advisers will find themselves subjected to these same requirements in the near future.

4. LPL Financial LLC (May 2015)

(a) In May 2015, LPL Financial LLC ("LPL") and FINRA entered into a Letter of Acceptance, Waiver and Consent ("AWC").[85] According to the AWC, LPL had in place a surveillance system that suffered from coding errors and therefore failed to generate alerts based on risk-based scenarios for customer ATM withdrawals. After the coding error was detected, LPL was unable to correct the coding promptly. According to FINRA, as a result, LPL failed to have a system reasonably designed to monitor for suspicious activity relating to customer ATM use.[86]

(b) In connection with settling these and other allegations, LPL consented to the imposition of a censure and a fine in the amount of $10 million. In addition, in connection with its surveillance system AML scenarios, LPL was required to conduct transactional look-backs for the periods during which the surveillance system was not fully functional.[87]

5. Halcyon Cabot Partners Ltd. (October 2015)

(a) In July 2015, FINRA filed a disciplinary proceeding against Halcyon Cabot Partners, Ltd. ("HCP"), Michael Trent Morris and Ronald Mark Heineman. On Oct. 6, 2015, FINRA entered an order accepting an offer of settlement from HCP, as well as Morris and Heineman, who were the firm's CCOs and AML officers during the relevant period.[88]

(b) FINRA alleged, among other things, that between 2010 and 2013, HCP, Morris and Heineman engaged in a scheme to defraud investors by causing HCP to serve as a bogus placement agent to conceal a kickback of a private placement fee, and caused the firm to serve as a false sales agent so that a now-expelled broker-dealer could charge commissions to both buyers and sellers in certain private sales of securities.[89]

(c) FINRA claimed that these and other violations were enabled by HCP's culture of non-compliance, which manifested itself in numerous supervisory violations and an inoperable AML program. Specifically, with respect to the AML program, FINRA alleged, among other things, that: (i) HCP had inadequate supervisory procedures because those procedures did not accurately reflected the risks posed by HCP's business model and the controls necessary to mitigate those risks; (ii) HCP failed to implement its AML program; (iii) HCP failed to detect and investigate red flags related to potentially suspicious securities transactions; and (iv) HCP did not have a qualified AML officer.[90]

[85] LPL Financial LLC, Letter of Acceptance, Waiver and Consent, No. 2013035109701 (May 6, 2015).

[86] *Id.*

[87] *Id.*

[88] Halcyon Cabot Partners, Ltd., Michael Trent Morris, and Ronald Mark Heineman, FINRA Disciplinary Proceeding No. 2012033877802 (Oct. 6, 2015).

[89] *Id.*

[90] *Id.*

(d) As a sanction, HCP was expelled from FINRA, and Morris and Heineman were barred from association with any FINRA member in any capacity.[91]

VIII. Whistleblowers Post-*KBR*

A. As part of a settled action, the SEC imposed a cease-and-desist order on engineering company KBR Inc., alleging that the company violated SEC Rule 21F-17 by forcing its employees to sign confidentiality statements related to its internal compliance investigations.[92]

1. Rule 21F-17(a) states: "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications."[93]

2. The SEC was not aware of any instance in which a KBR employee either had been prevented from revealing information to federal regulators, or had been subjected to discipline as a result of bringing any matter covered by the confidentiality statement to federal regulators. Nonetheless, the Commission alleged that "the language found in the form confidentiality statement impedes such communications by prohibiting employees from discussing the substance of their interview without clearance from KBR's law department under penalty of disciplinary action including termination of employment."[94]

B. The result of the settlement was that KBR paid a $130,000 fine and, most significantly, agreed to amend its confidentiality statement "to make clear that its current and former employees will not have to fear termination or retribution or seek approval from company lawyers before contacting [the SEC]," according to Sean McKessy of the SEC Office of the Whistleblower.[95] It is likely that the SEC will continue to bring actions against registered employers that have not reformed their confidentiality agreements in line with the SEC's view as expressed in *KBR* of what such confidentiality agreements may and may not contain.

---

[91] *Id.*

[92] KBR, Inc., Exchange Act Release No. 74619, 2015 WL 1456619 (April 1, 2015).

[93] 17 C.F.R. § 240.21F-17(a).

[94] KBR, Inc., Exchange Act Release No. 74619, 2015 WL 1456619 (April 1, 2015).

[95] Scott Hingham, "SEC Finds That KBR Confidentiality Agreements 'Stifled' Whistleblowers," *The Washington Post* (April 1, 2015), *available at* www.washingtonpost.com/investigations/sec-finds-that-kbr-confidentiality-agreements-stifled-whistleblowers/2015/04/01/c78f6708-d884-11e4-8103-fa84725dbf9d_story.html.

 © 2016 Schulte Roth & Zabel LLP

Recent Examinations: Substantive Areas of Regulatory Focus

Recent Examinations: Substantive Areas of Regulatory Focus

I. SEC and NFA Examinations and Enforcement Actions

A. In General: The SEC and NFA have expanded their examination programs in an effort to encompass the influx of advisers to private funds that are newly required to register pursuant to the Dodd-Frank Act. The SEC's Office of Compliance Inspections and Examinations ("OCIE") has developed new types of examinations and implemented new technologies to select advisers for examination and to aid the SEC staff in conducting examinations. OCIE has also hired personnel from the private sector and has been able to conduct more probing reviews of many private fund managers. The increasingly robust nature of SEC examinations, combined with a greater willingness by the OCIE staff to refer cases to the SEC's Division of Enforcement, has created an increased enforcement risk for private fund managers undergoing an SEC examination. Like the SEC, the NFA also expanded its examination program to handle the influx of newly registered CPOs and CTAs. While the NFA historically attempted to examine every member at least once every three years, that has proven difficult over the past few years, given the influx of new members. The NFA, however, appears to have reached appropriate staffing levels, resulting in many new members having recently gone through their first examination.

1. Risk-Based Examinations: Many recent examinations have been conducted on a "risk" basis, meaning that OCIE staff has analyzed data regarding the manager and funds, and has chosen the manager for examination based on perceived risks. With the aid of sophisticated new technologies, OCIE is able to more carefully and objectively prioritize advisers for examination. The NFA has also used new risk-based tools to determine which members should be examined on a non-routine basis. The NFA will look at factors such as customer complaints, habitually late filings and "red flags" in the periodic reports submitted to the NFA (i.e., Form CPO-PQR and pool financial statements).

2. Examinations for "Cause": Examinations for cause have continued to constitute a significant component of reviews of private fund managers. Whether such examinations are instigated by a potential whistleblower or by other tips, complaints or referrals ("TCRs"), these examinations are particularly sensitive because the examination staff may come in with an expectation of finding wrongdoing.[1]

B. Expenses

1. In General: Many recent examinations of both private equity and hedge fund managers have focused on the allocation of expenses, both between manager and funds, and between funds. Common deficiencies related to expense allocations have included: (1) over-allocating expenses to one client where another client will not pay such expenses (e.g., a managed account client won't pay for "broken-deal" expenses and the fund client therefore pays the full amount); and (2) charging expenses to the fund that are not clearly disclosed to investors (e.g., certain consultant expenses). Examination staff have been aggressively drilling down on expense allocations even where the amounts are de minimis. In addition, many examiners have requested that the manager itself conduct a thorough review of all expenses charged to clients. In anticipation of such scrutiny, many managers have conducted those reviews prior to examination and made remediation to affected funds where appropriate.

[1] Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations, Speech by SEC Staff: Remarks at the Compliance Outreach Program, Washington, D.C. (Jan. 31, 2012), *available at* www.sec.gov/News/Speech/Detail/Speech/1365171489758.

© 2016 Schulte Roth & Zabel LLP

2. KKR: On June 29, 2015, the SEC initiated, and settled, cease-and-desist proceedings against Kohlberg Kravis Roberts & Co. LP ("KKR") in connection with misallocation of expenses related to unsuccessful buyout opportunities ("broken deal expenses"). This was "the first SEC case to charge a private equity adviser with misallocating broken deal expenses."[2] KKR advises and manages its "flagship" private equity funds, along with co-investment vehicles. The limited partnership agreement for KKR's largest fund, the KKR 2006 Fund LP ("2006 Fund") allowed KKR to allocate broken deal expenses "incurred by or on behalf of" the 2006 Fund. According to the SEC, however, KKR did not also allocate the broken deal expenses to the co-investment vehicles and did not disclose the disparate treatment. As a result, KKR misallocated broken deal expenses of $17.4 million to the flagship funds.

3. Blackstone: On Oct. 7, 2015, the SEC initiated, and settled, cease-and-desist proceedings against Blackstone Management Partners LLC, Blackstone Management Partners III LLC, and Blackstone Management Partners IV LLC (collectively, "Blackstone"). These proceedings arose from alleged inadequate disclosures that involved two distinct breaches of fiduciary duty.[3] First, from at least 2010 through March 2015, upon either the private sale of a portfolio company or an initial public offering ("IPO"), Blackstone terminated certain portfolio company monitoring agreements and accelerated the payment of future monitoring fees as set forth in the agreements. Although Blackstone disclosed that it may receive monitoring fees from portfolio companies held by the funds it advised, and disclosed the amount of monitoring fees that had been accelerated following the acceleration, Blackstone failed to disclose to its funds, and to the funds' limited partners prior to their commitment of capital, that it may accelerate future monitoring fees upon termination of the monitoring agreements. Second, in late 2007, Blackstone negotiated a single legal services arrangement with its primary outside law firm (the "Law Firm") on behalf of itself and the funds. For the majority of legal services performed by the Law Firm beginning in 2008 and continuing through early 2011, Blackstone received a discount that was substantially greater than the discount received by the funds. The disparate legal fee discounts were not disclosed to the funds or the funds' limited partners until August 2012. Because of its conflict of interest as the recipient of the accelerated monitoring fees and the beneficiary of the disparate legal fee discounts, Blackstone could not effectively consent to either of these practices on behalf of the funds it advised. As a result, Blackstone breached its fiduciary duty to the funds in violation of Section 206(2) of the Advisers Act and also violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

4. Cherokee: On Nov. 5, 2015, the SEC initiated, and settled, cease-and-desist proceedings against Cherokee Investment Partners LLC ("CIP") and Cherokee Advisers LLC ("CA") (collectively referred to as "Cherokee") in connection with the alleged improper allocation to client funds (the "Cherokee Funds") of certain consulting, legal and compliance-related expenses.[4] Between July 2011 and March 2015, CIP and CA incurred consulting, legal and compliance-related expenses in the course of preparing for registration as an investment adviser under the Advisers Act, complying with legal obligations arising from registration and responding to the OCIE staff and the staff of the Commission's Division of Enforcement. Cherokee allocated to the Cherokee Funds, and caused the Cherokee Funds to pay for, $455,698 of these expenses. Although the Cherokee Funds' limited partnership agreements disclosed that the Cherokee Funds would be charged for expenses that in the good faith judgment of the general partner arose out of the operation and activities of the

[2] Press Release, Securities and Exchange Commission, SEC Charges KKR with Misallocating Broken Deal Expenses (June 29, 2015), *available at* www.sec.gov/news/pressrelease/2015-131.html.

[3] *In the Matter of Blackstone Management Partners L.L.C., Blackstone Management Partners III L.L.C., and Blackstone Management Partners IV L.L.C.*, Release No. IA-4219, Securities and Exchange Commission (Oct. 7, 2015).

[4] *In the Matter of Cherokee Investment Partners, LLC and Cherokee Advisers, LLC*, Release No. IA-4258, Securities and Exchange Commission (Nov. 5, 2015).

Cherokee Funds, including the legal and consulting expenses of the Cherokee Funds, there was no disclosure that the Cherokee Funds would be charged for the advisers' legal and compliance expenses. As a result, CIP and CA allegedly breached their fiduciary duties to the Cherokee Funds in violation of Section 206(2) of the Advisers Act and also allegedly violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

5. Cranshire: On Nov. 23, 2015, the SEC initiated, and settled, cease-and-desist proceedings against Cranshire Capital Advisors, LLC ("CCA") in connection with alleged negligent allocation of compliance-related expenses to a private fund client of CCA (the "CCA Fund").[5] From 2012 through 2014, CCA employed an outside attorney to serve as a compliance consultant to advise it on registration and compliance matters. The services provided by the consultant related to the creation and operation of CCA's compliance program rather than any investments or operations of the CCA Fund. During this period, CCA improperly used $158,650 in CCA Fund assets to pay the consultant's fees in a manner that was not disclosed in the CCA Fund's organizational documents. The CCA Fund's private placement memorandum and limited partnership agreement both disclosed that CCA would "provide the [CCA Fund] with office space and utilities. The [CCA Fund] will pay all its other expenses, including … legal and accounting fees." Similarly, an Omnibus Management Agreement covering the CCA Fund (the "Management Agreement") provided that CCA would render its services to the CCA Fund "at its own expense, including, without limitation, operating expenses (such as rent for office space and telephone lines) … unless such expenses are otherwise expenses to be borne by the Funds as described above." Regarding legal and compliance expenses, the Management Agreement stated only that "each Fund shall bear its own expenses, including … external legal expenses." The SEC found that none of these provisions authorized CCA to charge the CCA Fund for its own compliance consulting fees. As a result, CCA allegedly breached its fiduciary duty to the CCA Fund in violation of Section 206(2) of the Advisers Act and also allegedly violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

C. Conflicts and Disclosures (Including Marketing)

1. In General: In the past year, many government enforcement efforts with respect to private funds have also centered on conflicts of interest, as forewarned by Julie Riewe, co-chief of the Asset Management Unit of the SEC's Division of Enforcement, in her February 2015 speech, "Conflicts, Conflicts Everywhere."[6] Riewe made the following related points in her speech:

(a) The SEC staff are examining, at least in part, whether advisers are discharging their fiduciary obligation "to identify [their] conflicts of interest and either (1) eliminate them, or (2) mitigate them and disclose their existence to boards or investors." Advisers should ask the following questions:

(i) For each conflict identified, as a threshold matter, can the conflict be eliminated? If not, why not?

(ii) As to mitigation, are the firm's policies and procedures reasonably designed to address the conflicts the firm has identified, and are they properly implemented?

(iii) As to written disclosure, has the firm reviewed, and does the firm review regularly, all of the relevant disclosure documents to ensure that all conflicts are disclosed, and disclosed

[5] *In the Matter of Cranshire Capital Advisors*, LLC, Release No. IA-4277, Securities and Exchange Commission (Nov. 23, 2015).

[6] Securities and Exchange Commission, *Conflicts, Conflicts Everywhere – Remarks to the IA Watch 17th Annual IA Compliance Conference: The Full 360 View*, Washington, D.C. (Feb. 26, 2015), *available at* www.sec.gov/news/speech/conflicts-everywhere-full-360-view.html.

 © 2016 Schulte Roth & Zabel LLP

in a manner that allows clients or investors to understand the conflict, its magnitude and the particular risk it presents?

(b) The SEC staff expect to recommend a number of conflicts cases for enforcement action, including matters involving best execution failures, undisclosed outside business activities, related-party transactions, fee and expense misallocation issues, undisclosed bias toward proprietary products and investments, and conflicts presented by advisers using the fund's assets to grow the fund and, consequently, the adviser's own fee.

2. BlackRock: In April 2015 the SEC instituted a settled administrative proceeding against BlackRock Advisors LLC ("BlackRock"), alleging that BlackRock breached its fiduciary duty to its clients by failing to disclose a conflict of interest.[7] BlackRock portfolio manager Daniel J. Rice III, who managed energy-focused funds, founded Rice Energy, an oil and natural gas company, of which Rice was the general partner and in which Rice invested $50 million of his own money. Rice Energy formed a joint venture with a publicly traded coal company; that joint venture eventually became the largest holding in BlackRock's Energy & Resources Portfolio, which was managed by Rice. The SEC alleged that BlackRock knew and approved of Rice's involvement in the joint venture, but failed to disclose the conflict of interest to the boards of the registered funds or advisory clients. Blackrock was charged with certain violations of the Investment Advisers Act of 1940 (the "Advisers Act") that do not require scienter.

3. JP Morgan: On Dec. 18, 2015, the CFTC issued an order filing and settling charges against JPMorgan Chase Bank, N.A. ("JPMCB").[8] The CFTC found that JPMCB failed to disclose certain conflicts of interest to clients of its U.S.-based wealth management business, J.P. Morgan Private Bank. Specifically, JPMCB failed to fully disclose its preference for investing its client funds in certain commodity pools or exempt pools, namely hedge funds and mutual funds managed and operated by an affiliate and subsidiary of JP Morgan Chase & Co. JPMCB also failed to disclose its preference for investing its clients' funds in third-party-managed hedge funds, each a commodity pool or exempt pool, that shared management and/or performance fees with a JPMCB affiliate. Aitan Goelman, the CFTC's Director of Enforcement, commented that "Investors are entitled to know if a bank managing their money favors placing investments in its own proprietary funds or other vehicles that generate fees for the bank."

4. Guggenheim: In another matter highlighting the SEC staff's focus on conflicts of interest issues, the SEC brought charges in August 2015 against Guggenheim Partners Investment Management LLC ("Guggenheim"), an investment adviser that provides investment management services primarily to institutional clients, high-net-worth individuals and private funds.[9] The SEC alleged that a senior Guggenheim executive obtained a loan from an advisory client in July 2010. The next month, the same executive invested both that client and other clients in two transactions, but did so on different terms for the client from whom he had obtained the loan. The SEC alleged that although senior officials at Guggenheim were aware of the loan, none of them informed the company's compliance staff, nor was the loan disclosed to the other advisory clients. As noted by Andrew J. Ceresny, Director of the SEC Division of Enforcement, "As fiduciaries, investment advisors must be vigilant about disclosing all material facts to their clients, including actual and potential conflicts of

[7] Press Release, Securities and Exchange Commission, SEC Charges BlackRock Advisors with Failing to Disclose Conflict of Interest to Clients and Fund Boards (April 20, 2015), *available at* www.sec.gov/news/pressrelease/2015-71.html.

[8] Press Release, Commodity Futures Trading Commission, CFTC Orders JPMorgan Chase Bank, N.A. to Pay $100 Million for Failure to Disclose Conflicts of Interest (Dec. 18, 2015), *available at* www.cftc.gov/PressRoom/PressReleases/pr7297-15.

[9] Press Release, Securities and Exchange Commission, Guggenheim Partners Investment Management LLC Settles Charges It Failed to Disclose Conflict to Clients (Aug. 10, 2015), *available at* www.sec.gov/news/pressrelease/2015-162.html.

© 2016 Schulte Roth & Zabel LLP

interest."[10] Guggenheim was charged with certain violations of the Advisers Act that do not require scienter.

5. Reliance: In December 2014, the SEC brought a litigated administrative proceeding, in which it alleged scienter-based fraud charges against Reliance Financial Advisers ("Reliance") and its two co-owners, alleging that the firm made false and misleading statements to clients when recommending investments in a risky hedge fund. The SEC alleged that Reliance encouraged clients to invest in the Prestige Fund, a hedge fund managed by Scott Stephan. Although Stephan had virtually no hedge fund investing experience, Reliance allegedly disseminated materials claiming that the fund was an appropriate investment for retirees living on fixed incomes or for those nearing retirement. The Prestige Fund's trading strategy was described to prospective investors as being fully automatic and governed by a computer algorithm. The Prestige Fund collapsed after losing 80 percent of its value as a result of Stephan manually placing trades, contrary to the automated trading strategy marketed to investors. In a statement, Andrew Calamari, director of the SEC's New York Regional Office, argued that Reliance's co-owners violated their fundamental duty of complete candor "by peddling a hedge fund investment that was more risky than depicted and misleading their clients about the portfolio manager's experience."

6. Citigroup: In August 2015, the SEC instituted a settled administrative proceeding charging that two affiliates of Citigroup defrauded investors in two hedge funds by claiming they were safe, low-risk and suitable for traditional bond investors.[11] Although the written materials provided to investors contained truthful disclosures, the SEC alleged that Citigroup Global Markets Inc. ("CGMI") and Citigroup Alternative Investments LLC ("CAI"), both registered investment advisers, failed to disclose the high risks of investing in the funds in verbal conversations with investors, and continued to accept investments even as the funds began to collapse amid the financial crisis. As noted by Andrew Ceresney, "Firms cannot insulate themselves from liability for their employees' misrepresentations by invoking the fine print contained in written disclosures."[12] CGMI and CAI were charged with certain violations of the Securities Act of 1933 and the Advisers Act that do not require scienter.

7. Ranieri: On March 8, 2013, the SEC filed and settled charges against Ranieri Partners LLC, Donald Phillips (a former senior executive at Ranieri Partners) and William Stephens (an external marketing consultant to Ranieri Partners).[13] The SEC alleged that Stephens acted as an unregistered broker in violation of Section 15(a) of the Securities Exchange Act in marketing and receiving placement fees for the sale of interests in two real estate funds organized and advised by Ranieri Partners. The settlement orders cite a number of factors as support for this allegation, including the fact that Stephens received "transaction-based compensation totaling approximately $2.4 million." The Ranieri case has two particular points of interest for private fund managers: First, unlike many other cases brought for failure to register as a broker-dealer, there were no allegations of fraud. Second, in addition to charging the consultant for failing to register as a broker-dealer, the SEC charged the private fund manager itself and a former senior executive at the manager.

D. Insider Trading

---

[10] *Id.*

[11] Press Release, Securities and Exchange Commission, Citigroup Affiliates to Pay $180 Million to Settle Hedge Fund Fraud Charges (Aug. 17, 2015), *available at* www.sec.gov/news/pressrelease/2015-168.html.

[12] *Id.*

[13] *In the Matter of Ranieri Partners LLC and Donald W. Phillips*, Securities Exchange Act Release No. 69091, Investment Advisers Act of 1940 Release No. 3563, Administrative Proceeding File No. 3-15234 (March 8, 2013); *In the Matter of William M. Stephens*, Securities Exchange Act Release No. 69090, Investment Company Act of 1940 Release No. 30417, Administrative Proceeding File No. 3-15233 (March 8, 2013).

 © 2016 Schulte Roth & Zabel LLP

1. Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder prohibit the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.[14] Similarly, CFTC Rule 180.1 may prohibit a person from trading commodity interests on the basis of material nonpublic information in breach of a pre-existing duty (established by another law or rule, agreement, understanding or some other source), or trading on the basis of material nonpublic information that was obtained through fraud or deception.[15] While the CFTC has to date only brought one insider trading case, it has stated that it "will be guided, but not controlled, by the substantial body of judicial precedent applying the comparable language of SEC Rule 10b-5."

2. Galleon Cases: Since 2009, the SEC has charged 35 defendants trading in the securities of 15 companies generating illicit profits of more than $96 million.[16] A total of 34 defendants have settled the SEC's charges. The alleged illegal conduct involved Raj Rajaratnam and his New York-based hedge fund Galleon Management making cash payments in exchange for material nonpublic information. The case eventually implicated corporate executives, consultants, rating agency personnel, proprietary traders, hedge fund executives and public relations personnel.

3. Newman: Recently, the U.S. Court of Appeals for the Second Circuit reversed two high-profile insider trading convictions in *U.S. v. Newman*.[17] On Dec. 10, 2014, the Second Circuit held that to sustain insider trading charges against a tippee who trades on material nonpublic information, the government must prove that the tippee knew that the tipper disclosed the information in breach of a duty of trust and confidence in order to receive a personal benefit. The court further explained that the benefit must be objective and consequential. In doing so, the court criticized the government for "the doctrinal novelty of its recent insider trading prosecutions," which the court described as "increasingly targeted at remote tippees many levels removed from corporate insiders." Additionally, *Newman* rejects the notions that mere ephemeral benefits would suffice to constitute the breach, and that the tippee need not know that a personal benefit was the quid pro quo for the improper disclosure. Accordingly, the decision is expected to present new obstacles to criminal prosecutions and SEC enforcement actions alleging insider trading violations, particularly against remote tippees. We may already be seeing the effects of the decision in the Manhattan U.S. Attorney's Office dismissing criminal charges against a dozen people besides Todd Newman and co-defendant Anthony Chiasson — 10 of whom had already pled guilty to insider trading[18] — and in an in-house judge dismissing an SEC administrative proceeding against former Wells Fargo trader Joseph Ruggieri, after finding the Enforcement Division did not prove Ruggieri's alleged tipper received a significant personal benefit for his information.[19]

---

[14] 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b–5.

[15] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41398, 41399 (July 14, 2011).

[16] Securities and Exchange Commission, SEC Enforcement Actions: Insider Trading Cases, *available at* www.sec.gov/spotlight/insidertrading/cases.shtml.

[17] *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

[18] Ed Beeson, "SEC Retooling Insider Trading Tactics After Newman," *Law360* (Nov. 4, 2015), *available at* www.law360.com/articles/723289/sec-retooling-insider-trading-tactics-after-newman.

[19] *In the Matter of Gregory T. Bolan, Jr., and Joseph C. Ruggieri*, Initial Decision Release No. 877, Securities and Exchange Commission (Sept. 14, 2015).

© 2016 Schulte Roth & Zabel LLP

4. Motazedi: On Dec. 2, 2015, the CFTC brought and settled an action against Arya Motazedi, a proprietary gasoline and energy trader at an unnamed public company in Chicago.[20] According to the CFTC, Motazedi had access to confidential, proprietary information concerning his employer's proprietary trading in energy commodities (e.g., timing, amounts and prices) and he used that knowledge: (i) to enter "opposite side" orders that matched with his employer's orders at least 34 times (causing the employer's account to buy energy futures at higher prices and sell at lower prices, profiting Motazedi and harming his employer), at least some of which were designed as "round trip" transactions (where both sides bought and sold with the other and neither party experienced a net change in its positions); and (ii) to "front run," on at least 12 occasions, his employer's orders (allowing Motazedi to benefit from any subsequent price movement caused by the subsequent execution of the employer's oil and gas futures orders). The CFTC noted that, of the two accounts that Motazedi controlled and utilized in these activities, he only owned one of them.

5. Riley: On March 4, 2015, the U.S. District Court for the Southern District of New York refused to reverse the insider trading conviction of former Foundry Networks Inc. executive David Riley.[21] Prosecutors alleged that Riley provided his friend Matthew Teeple, a former hedge fund analyst, with Foundry's financial data and advance notice of its 2008 acquisition by Brocade Communications Systems Inc. Citing the redefined personal benefit standard in *U.S. v. Newman*, Riley has argued to the Second Circuit that his conviction should be overturned because the jury instructions did not require jurors to find that he had received a personal benefit in exchange for providing information to Teeple. Judge Caproni of the Southern District of New York had held that the instructions were not improper because maintaining a friendship could be circumstantial evidence that the tipper and tippee had a "quid pro quo relationship." The court also pointed out that Riley had received "concrete" benefits in exchange for providing the inside information, namely investment advice, assistance with a side business, and help finding a new job.[22] Riley filed his appeal on Aug. 28, 2015.[23]

6. Policies and Procedures

   Rule 206(4)-7 of the Advisers Act provides that if you are an investment adviser registered or required to be registered under the Advisers Act, you must: (i) adopt and implement written policies and procedures reasonably designed to prevent violation, by you and your supervised persons, of the applicable federal securities laws; (ii) review, no less frequently than annually, the adequacy of such policies and procedures; and (iii) designate an individual (who is a supervised person) responsible for administering your policies and procedures.[24]

7. Importance of Documentation

   (a) SEC Document Requests: When the SEC staff conducts an examination of an adviser, they request information and documents from the adviser to assess the adviser's compliance with the applicable federal securities laws, including the Advisers Act and the Company Act. Ensuring documentation of compliance policies, procedures and the implementation of such

[20] *In the Matter of Arya Motazedi*, CFTC Docket No. 16-02 (Dec. 2, 2015). *See also* "The CFTC Brings (and Settles) Its First Insider-Trading Case: Implications for All Private Fund Managers," SRZ Alert (Dec. 15, 2015), *available at* www.srz.com/files/News/8ab2bc57-805e-4074-b7f6-9b16fec6c213/Presentation/NewsAttachment/86944d3b-244c-464f-82da-2195866c0973/121515_The_CFTC_Brings_and_Settles _Its_First_Insider_Trading_Case_Implications_for_All_Private_Fu.pdf.

[21] Jonathan Stempel, "U.S. Judge Upholds Insider Trading Conviction Despite Law Change," *Reuters* (March 4, 2015), *available at* www.reuters.com/article/us-usa-insidertrading-riley-idUSKBN0M02BE20150304.

[22] Docket Entry No. 252, *United States v. Riley*, No. 13-CR-339-1 (VEC) (S.D.N.Y. March 3, 2015).

[23] Docket Entry No. 44, *United States v. Riley*, No. 15-1541 (2d Cir. Aug. 28, 2015).

[24] 17 CFR 275.206(4)-7.

© 2016 Schulte Roth & Zabel LLP

policies and procedures is, therefore, critical to preparing for an SEC examination. A document request list from the SEC staff may include, among other things:

(i) The firm's organizational charts;

(ii) Demographic and other data for advisory clients, including privately offered funds;

(iii) A trade blotter, i.e., a record of all trades placed for its clients/funds (including all trade errors, cancellations, re-bills and reallocations);

(iv) Information about the firm's compliance risks;

(v) The written policies and procedures that the firm has established and implemented;

(vi) Documents relating to the firm's compliance testing (e.g., the results of any compliance reviews, quality control analyses, surveillance, and/or forensic or transactional tests performed by the firm);

(vii) Information regarding actions taken as a result of compliance testing (e.g., any warnings to or disciplinary action of employees, changes in policies or procedures, redress to affected clients, or other measures);

(viii) Any restricted, watch, or grey lists that were in effect for the examination period;

(ix) Any threatened, pending and settled litigation or arbitration involving the firm or any "supervised person"; and

(x) Any client complaints.

E. Tag Along: From Examination to Enforcement

1. In general: There is a close connection between SEC examinations and enforcement actions as highlighted by Riewe in her February 2015 speech. Riewe noted there is close coordination and collaboration between the Enforcement Division and OCIE and that the Enforcement Division has always worked many cases referred by exam staff.[25] While she said she believed that not every exam deficiency warrants an enforcement response, she acknowledged it was important that exam staff have the ability to refer matters when in their judgment the conduct warrants enforcement action. Furthermore, the 2015 Agency Financial Report by the SEC provides that in fiscal year 2015, OCIE made more than 200 referrals, many of which resulted in enforcement investigations and/or actions.[26] The NFA tends to handle many of its enforcement actions internally and generally refers only the more serious allegations to the CFTC. NFA enforcement actions are generally related to conflicts of interest issues, late filings and failing to disclose or incorrectly disclosing conflicts, past performance, expenses and other related exposures. Trading-related issues are generally handled by the futures exchanges (who could also refer such cases to the CFTC).

2. Trend: While there have long been examinations that led to enforcement investigations, there is evidence indicating that the rate of referrals to the Enforcement Division has increased. OCIE's regional offices increased the number of cases referred to enforcement from 232 in fiscal year 2006

---

[25] Riewe, *supra* note 6.

[26] Securities and Exchange Commission, Agency Financial Report, Fiscal Year 2015 (2015), *available at* www.sec.gov/about/secpar/secafr2015.pdf.

© 2016 Schulte Roth & Zabel LLP

to 272 in fiscal year 2010, with a particularly large increase between fiscal year 2008 (198 cases) and fiscal year 2010.[27] Additionally, the SEC's Office of the Inspector General published a report in June 2001 stating that approximately 5 percent of investment adviser examinations result in a referral to the Enforcement Division, which can be contrasted with OCIE Director Andrew Bowden's recent statement that approximately 10 percent of investment adviser examinations result in a referral to enforcement.[28] Several Enforcement Division attorneys have also moved to OCIE, including the head of the investment adviser examination program in the New York Regional Office,[29] which covers a large segment of the private funds industry.

3. Notable Cases

(a) Transamerica: Transamerica Financial Advisors Inc. ("TFA"), a registered investment adviser and broker-dealer, allegedly failed to apply advisory fee discounts to certain retail clients in several of its advisory fee programs contrary to its disclosures to clients and its policies and procedures.[30] During the relevant period, TFA offered clients in these programs breakpoint discounts that reduced the total advisory fee as the clients' assets in the programs increase. In various Form ADV Part 2 filings and in account opening documents, TFA represented that clients may request that TFA aggregate the values of certain related accounts to achieve these discounts. In addition, TFA's policies and procedures required that clients receive the savings from breakpoint discounts. Despite these disclosures, from January 2009 to June 30, 2013, TFA allegedly failed, in certain instances, to apply the breakpoint discounts despite client requests for aggregation. The Commission's examination staff first alerted TFA to certain of these problems in early 2010, but TFA failed to take adequate remedial steps. As a result, TFA allegedly improperly calculated advisory fees and thereby overcharged certain client accounts.

(b) ZPR: On April 4, 2013, the SEC initiated cease-and-desist proceedings against ZPR Investment Management Inc. ("ZPR") following an SEC examination that showed ZPR's performance marketing to be misleading because ZPR claimed compliance with the Global Investment Performance Standards when that was not the case.[31]

(c) GMB: On April 20, 2012, the SEC initiated, and settled, cease-and-desist proceedings against GMB Capital Management LLC and GMB Capital Partners LLC (collectively "GMB") following an SEC examination of GMB that showed misrepresentations regarding performance, misrepresentations regarding fund strategy, and creation of false documents during the course of the examination to try to support the performance claims.[32]

(d) F-Squared: On Dec. 22, 2014, the SEC initiated, and settled, cease-and-desist proceedings against F-Squared Investments Inc. ("F-Squared") following an SEC examination that showed

---

[27] Office of Inspector General, Securities and Exchange Commission, *OCIE Regional Offices' Referrals to Enforcement*, Report No. 493 (March 30, 2011), *available at* www.sec.gov/oig/reportspubs/493.pdf.

[28] *Compare* Office of Inspector General, Securities and Exchange Commission Audit No. 322, Compliance Inspection and Examination Referrals to Enforcement (June 28, 2001), *available at* www.sec.gov/about/oig/audit/322fin.pdf, *with* Yin Wilczek, "Only One in 10 SEC Exams Referred for Enforcement Action, Official Says," *Bloomberg BNA* (March 15, 2013).

[29] Press Release, Securities and Exchange Commission, Ken C. Joseph Named Head of Investment Adviser/Investment Company Examination Program in SEC's New York Regional Office (July 3, 2012), *available at* www.sec.gov/News/PressRelease/Detail/ PressRelease/1365171483018.

[30] *In the Matter of Transamerica Financial Advisors, Inc.*, Release No. 3808, Securities and Exchange Commission (April 3, 2014).

[31] *In the Matter of ZPR Investment Management, Inc. and Max E. Zavanelli*, Release No. IA 3574, Securities and Exchange Commission (April 4, 2013).

[32] *In the Matter of GMB Capital Management LLC, GMB Capital Partners LLC, Gabriel Bitran and Marco Bitran*, Release No. IA 3399, Securities and Exchange Commission (April 20, 2012).

© 2016 Schulte Roth & Zabel LLP

back-tested returns were not properly identified as such.[33] F-Squared settled, agreeing to disgorgement and penalties of $35 million. The former CEO of F-Squared was charged with fraud under Sections 206 and 207 of the Advisers Act for his role in the misleading performance marketing.

(e) Alpha Titans: The SEC settled administrative and cease-and-desist proceedings against a registered adviser, Alpha Titans LLC, its principal and its general counsel for non-scienter fraud, custody rule and compliance charges.[34] The OCIE examination identified that the adviser and key individuals used assets of two affiliated private funds to pay for most of the firm's operating expenses, but it did not seek clear investor authorization to do so.[35] The funds' financial statements provided to investors also were misleading because they did not disclose the use of the funds' money by entities that its principal controlled.

(f) Other notable cases include the KKR case discussed above and *In the Matter of AlphaBridge Capital Management, LLC*,[36] in which the SEC settled administrative proceedings against a registered adviser, AlphaBridge Capital Management LLC ("Alphabridge"), and its two principals for their alleged fraudulent inflation of the prices of mortgage-backed securities held by certain private funds managed by AlphaBridge.

4. Whistleblowers

(a) KBR: On April 1, 2015, the SEC initiated, and settled, cease-and-desist proceedings against Houston-based global technology and engineering firm KBR Inc. for violating whistleblower protection Rule 21F-17 enacted under the Dodd-Frank Act.[37] KBR required witnesses in certain internal investigation interviews to sign confidentiality statements with language warning that they could face discipline and even be fired if they discussed the matters with outside parties without the prior approval of KBR's legal department. Since these investigations included allegations of possible securities law violations, the SEC found that these terms violated Rule 21F-17, which prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC. Increased protection for whistleblowers may lead to increased whistleblowing and related examinations or enforcement actions.

(b) Statistics: For each year that the whistleblower program has been in operation, the SEC has received an increasing number of whistleblower tips.[38] The number of whistleblower tips increased as follows: 334 in 2011; 3,001 in 2012; 3,238 in 2013; 3,620 in 2014; and 3,923 in 2015. The Office of the Whistleblower currently is tracking over 700 matters in which a whistleblower's tip has caused a Matter Under Inquiry or investigation to be opened or has been forwarded to Enforcement staff for review and consideration in connection with an ongoing investigation.

---

[33] *In the Matter of F-Squared Investments, Inc.*, Release No. IA 3988, Securities and Exchange Commission (Dec. 22, 2014).

[34] *In the Matter of Alpha Titans, LLC*, Release No. IA 4073, Securities and Exchange Commission (April 29, 2015).

[35] Agency Financial Report, Fiscal Year 2015, *supra* note 21.

[36] Release No. IA 4135, Securities and Exchange Commission (July 1, 2015).

[37] Press Release, Securities and Exchange Commission, SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements (Apr. 1, 2015), *available at* www.sec.gov/news/pressrelease/2015-54.html.

[38] Securities and Exchange Commission, 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program (2015), *available at* www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf.

 © 2016 Schulte Roth & Zabel LLP

(c) Paradigm Capital: In 2015, the SEC's Whistleblower Program awarded eight whistleblowers with total awards of approximately $38 million,[39] including the following case: On April 28, 2015, the SEC announced a maximum whistleblower award payment of 30 percent of amounts collected in connection with *In the Matter of Paradigm Capital Management, Inc. and Candace King Weir*, File No 3-15930 (June 16, 2014), the Commission's first anti-retaliation case.[40] The proceedings involved a whistleblower who reported certain trading activity revealing that Candace King Weir ("Weir") caused her affiliated investment adviser Paradigm Capital Management Inc. ("Paradigm") to engage in principal transactions with C.L. King & Associates Inc., an affiliated broker-dealer owned by Weir, without providing effective disclosure to, or obtaining effective consent from, PCM Partners LP II, a hedge fund client advised by Paradigm.[41] The whistleblower received over $600,000 for providing information that led to the success of the SEC action.

(d) The CFTC's whistleblower program is relatively new and was established under the Dodd-Frank Act. The program was closely modeled after the SEC's program, although the CFTC has only paid out two whistleblower awards to date: a $240,000 payout in 2014 and $290,000 in September 2015. The CFTC did not provide any details regarding the resulting enforcement actions.

[39] Press Release, Securities and Exchange Commission, SEC Announces Enforcement Results For FY 2015 (Oct. 22, 2015), *available at* www.sec.gov/news/pressrelease/2015-245.html.

[40] *See* Order Determining Award Claim, Exchange Act Rel No 74826, File No 2015-4 (April 28, 2015). The name of the case was included in the final order and accompanying press release because such information was already in the public domain in light of the earlier enforcement action in this matter

[41] *In the Matter of Paradigm Capital Management, Inc. and Candace King Weir*, Release No. IA 3857, Securities and Exchange Commission (June 16, 2014).

 © 2016 Schulte Roth & Zabel LLP

Trading Compliance: Managing Regulatory Risk

Trading Compliance: Managing Regulatory Risk

I. Rule 105 of Regulation M and Regulation SHO

A. Generally: What Is Rule 105?

Rule 105 makes it unlawful for any person to "sell short" during the "Rule 105 restricted period" an equity security that is being offered for cash pursuant to a registration statement in a firm commitment underwritten offering and purchase the offered securities.

B. Why Is Rule 105 Significant, and Why Does Preparation Matter?

1. Rule 105 enforcement rose sharply in 2010.

2. Rule 105 is a prophylactic rule, and therefore, 105 actions are easy to bring — if there is a violation, there is no legal defense. There is no requirement of intent to manipulate the price of the security.

3. Rule 105 is not intended to catch only systematic "scams" — even a single violation can lead to charges.

4. Charges can be based on even trivial profits, but penalties, in addition to disgorgement of profits, can constitute a significant percentage of the overall resolution.

5. Rule 105 violations are also subject to various reporting requirements (e.g., 13D, ADV) (but note that a Rule 105 violation does not automatically trigger the "bad actor" rule under Regulation D).

6. Rule 105 violations fall under the category of "market manipulation" and can also lead to censure, suspension or a lifetime ban of being associated with an investment adviser or broker-dealer, all of which can cause investor concern and affect a firm's ability to keep and/or raise capital.

C. How to Avoid a Rule 105 Violation: A Checklist of Rule 105 Provisions

1. What types of offerings does Rule 105 apply to? Firm commitment underwritten offerings of equity securities:

(a) How do you distinguish between a firm commitment offering and best efforts offering?

(i) Firm Commitment Underwritten Offering: A firm commitment underwritten offering is generally one where one or more investment banks agree to act as an underwriter and are thereby obligated to purchase a fixed number of securities from the issuer, which they resell to the public.

(ii) Best Efforts Offering: An investment bank agrees to act as placement agent to do its best to sell the offering to the public but does not buy the securities from the issuer and does not guarantee that it will sell any amount of the securities.

(b) What is the subject equity security?

(i) Rule 105 only applies to equity securities.

© 2016 Schulte Roth & Zabel LLP

(ii) An offering of non-convertible debt would not fall under the rule. An offering of convertible debt would fall under the rule, as convertible debt is itself an equity security. However, the rule prohibits only the selling short of the "security that is the subject" of the offering; therefore a short sale of the underlying common stock would not prohibit participation in an offering of the convertible debt. However, the general anti-fraud and anti-manipulation provisions of the federal securities laws still apply.

(iii) Options and other derivatives are not considered equity securities under the rule. However, again, the SEC has made clear that the anti-fraud and anti-manipulation provisions of the federal securities laws still apply in this context.

(c) Global Offerings and Short Sales Abroad

(i) A person cannot participate in an offering in the United States if he or she sold the subject securities short on a foreign exchange during the Rule 105 restricted period.

(ii) In an entirely foreign distribution of a security that has no market in the United States, but whose reference security does have a market in the United States, the foreign distribution is not subject to Regulation M. For example, Rule 105 does not prohibit a short sale of common stock in a foreign offering during the Rule 105 restricted period and participation in an offering for ADRs because they are not the same subject security. However, the general anti-fraud and anti-manipulation provisions of the federal securities laws may apply to any transaction effected in the United States. Be especially careful here because the ADR can essentially be seen as a re-packaging of the common stock.

2. Rule 105 Restricted Period: The shorter of the period: (i) beginning five business days before the pricing of the offered securities and ending at pricing; and (ii) beginning at the initial filing of the registration statement and ending at pricing.

(a) How is the five-business-day period calculated?

(i) "Business day" refers to a 24-hour period determined with reference to the principal market for the securities to be distributed, and that includes a complete trading session for that market.

(ii) If pricing occurs after the principal market closes, then the day of pricing is included in the five-business-day period. For example, if pricing occurs on a Thursday after the principal market closes, then the restricted period would begin at the close of trading on the previous Thursday and end at pricing on the following Thursday.

(iii) Problems with Holidays: If the principal market is closed for a holiday, then such date will not count as a business day within the five-business-day period.

(b) How is the period beginning from the initial filing of the registration statement calculated?

(i) The period begins with the issuer's initial filing of a registration statement for secondary offerings. Oftentimes this is done well in advance (sometimes years) before the secondary offering at hand. But sometimes it is done by WKSIs (because they can file an automatic shelf registration statement) right before the offering, in which case, this period may be shorter than the five-business-day period.

 © 2016 Schulte Roth & Zabel LLP

(ii) A prospectus supplement containing the specific information with respect to the offering might be filed right before the offering. This is not the initial registration statement.

3. What is a short sale?

(a) Definition Under Section 200(a) of Regulation SHO: "The term short sale shall mean any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller."

(b) When does a person own a security?

(i) The person has title to it.

(ii) The person has purchased it pursuant to an unconditional contract, binding on both parties, to purchase it but has not yet received it.

(iii) The person owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange.

(iv) The person has an option to purchase it and has exercised the option.

II. Section 13(d) and Section 16 Reporting Requirements Under the Securities Exchange Act of 1934 (the 'Exchange Act')

A. Section 13(d) Reporting Requirement Trigger

1. Upon becoming a greater than 5-percent "beneficial owner" of any voting, equity security registered under the Exchange Act ("Subject Securities")

(a) A beneficial owner of a security includes any person who, *directly or indirectly*, through any contract, arrangement, understanding, relationship or otherwise has or shares *voting power* and/or *investment power* with respect to such security. An investment manager's beneficial ownership should be calculated based on the aggregate positions of all entities it manages that are not disaggregated from each other for purposes of Section 13(d) and Section 16 reporting.

(i) Voting power includes the power to vote, or to direct the voting of, a security.

(ii) Investment power includes the power to dispose, or the power to direct the disposition, of a security.

(b) Rule 13d-3(d)(1)(i) provides that a person is deemed to be the beneficial owner of a security if that person has the right to acquire beneficial ownership of that security within 60 days.[1]

(c) Rule 13d-5(b)(1) provides that when two or more persons agree (whether formal or informal, orally or in writing) to act together for the purpose of acquiring, holding, voting or disposing

[1] However, non-passive holdings confer beneficial ownership for a right to acquire at any time — even after 60 days. This important exception to the 60-day rule provides that any person who has a right to acquire beneficial ownership of a security with the purpose or effect of changing or influencing control of the issuer, or in connection with or as a participant in any transaction having such purpose or effect, is deemed to be a beneficial owner of the security immediately upon acquiring the right to acquire the security regardless of whether that right cannot be exercised within 60 days. Nonetheless, a person does not beneficially own subject securities underlying a derivative security if the right to acquire the underlying subject security is subject to material contingencies outside the control of such person that cannot be waived (e.g., the requirement to obtain a governmental approval or the effectiveness of a registration statement). Such a right does not create beneficial ownership until the contingency is met even where these material contingencies could be met within the 60-day period.

© 2016 Schulte Roth & Zabel LLP

of subject securities, all members of the group formed thereby will be deemed to have beneficial ownership of all subject securities beneficially owned by the other members of the group.

(i) To be a member of a group a person first must be the beneficial owner of subject securities.

(ii) Private investment funds, mutual funds, private equity funds and similar investment vehicles ("Funds") with a common investment manager may be deemed to be a group if the investment manager(s) make similar acquisitions and dispositions of subject securities on behalf of the Funds at the same time or there is a common plan or goal among the investment manager(s) for the Funds. Depending on the facts, it is even possible for a managed account client to be deemed to be a group with the investment manager managing its account. Relevant facts to consider include transparency of trading data or other sharing of information related to a subject security and whether the client trades the subject security outside of the account in a manner that is similar to the trading done in the account.

(iii) If considered a group, the subject securities held by the Funds and/or clients must be aggregated when determining whether the 5-percent threshold has been crossed.[2]

(iv) A group can also be formed with unaffiliated entities or persons if an agreement as to the acquisition, holding, voting or disposition of subject securities exists.

B. Type of Filing Required: Schedule 13D or the Short Form Schedule 13G?

1. Section 13(d) of the Exchange Act requires a beneficial owner that acquires more than 5 percent of a class of subject securities to file on Schedule 13D unless eligible to file on Schedule 13G.

(a) The initial Schedule 13D filing must be made within 10 calendar days of crossing 5 percent.

(b) Amendments must be made "promptly"[3] upon any material change in the information previously reported.

(i) An acquisition or disposition of 1 percent or more of the class of securities is deemed to be a material change requiring an amendment.

(ii) Another common amendment trigger is any material change to a filer's plans or proposals with respect to the issuer (under Item 4 of Schedule 13D).

2. Eligibility to File on Schedule 13G

(a) 13d-1(b) Qualified Institutional Investors: Certain institutional investors (e.g., registered investment advisers, registered investment companies and registered brokers or dealers) may file on Schedule 13G as long as they have acquired the subject securities in the ordinary course

[2] The common investment manager(s) would be deemed to beneficially own the aggregate number of subject securities held across the Funds/client accounts regardless of whether the Funds and/or accounts are deemed to be a group. So, it is the aggregate ownership across the Funds and accounts that would trigger a filing and be reported in either case. Accordingly, the Funds and/or accounts being deemed to be a group is of little consequence in terms of triggering a filing requirement. However, the finding of group status could subject the Funds and accounts to individual reporting and Section 16's short-swing profit rules and require accelerated Schedule 13G reporting under Rule 13d-1(c), as discussed below.

[3] "Promptly" is not defined in the rules but has generally been interpreted by courts to mean not more than two business days.

© 2016 Schulte Roth & Zabel LLP

of business and not with the purpose nor with the effect of changing or influencing the control of the issuer.

(i) The initial Schedule 13G is required to be filed within 45 days after the end of the calendar year if the beneficial ownership of the reporting person(s) exceeds 5 percent as of Dec. 31; provided, that, if the reporting person(s) beneficial ownership exceeds 10 percent prior to the end of the calendar year, the reporting person's or persons' initial Schedule 13G must be filed within 10 days after the end of the first month in which the reporting person's or persons' beneficial ownership exceeds 10 percent on the last day of the month.

(ii) Amendments are required:

(1) Within 45 days of the end of the calendar year if, as of Dec. 31, there is any change in the information previously reported (unless the only change is a change in the percentage beneficially owned and such change is a result of a change in the number of shares of the class outstanding);

(2) Within 10 calendar days after the end of any month in which beneficial ownership exceeds 10 percent as of the end of the month; and

(3) Once over 10 percent, within 10 calendar days of the end of any month in which beneficial ownership increases or decreases by more than 5 percent as of the end of the month.

(b) 13d-1(c) Passive Investors: Investors that are not one of the types of institutional investors permitted to file under Rule 13d-1(b) may file under Rule 13d-1(c) as long as they have not acquired the subject securities with the purpose, or with the effect of, changing or influencing control of the issuer *and* their beneficial ownership does not constitute 20 percent or more of the class of subject securities.

(i) The initial Schedule 13G is required within 10 days of crossing 5-percent beneficial ownership.

(ii) Amendments are required:

(1) Within 45 days of the end of the calendar year if, as of Dec. 31, there is any change in the information previously reported (unless the only change is a change in the percentage beneficially owned and such change is a result of a change in the number of shares of the class outstanding);

(2) "Promptly" upon crossing 10-percent beneficial ownership; and

(3) Once over 10 percent, "promptly" after beneficial ownership increases or decreases by more than 5 percent.

(c) 13d-1(d) Exempt Investors: Investors who are or become the beneficial owner of more than 5 percent of a class of subject securities *but* who have not made an "acquisition" subject to Section 13(d) are permitted to file on Schedule 13G (e.g., those who become beneficial owners of more than 5 percent of a class of subject securities as a result of a stock buy-back or those who owned the subject security prior to the subject security becoming registered under the

© 2016 Schulte Roth & Zabel LLP

Exchange Act).[4] This provision is available regardless of control intent or ownership level. The ability to file under 13d-1(d) is lost if the investor acquires more than 2 percent of the class of subject securities within any 12-month period. For example, if the investor acquired 1.5 percent of the subject security two months prior the Exchange Act registration and one month following the registration acquired another 0.6 percent of the subject security, the ability to file under 13d-1(d) would be lost, and instead of filing under Rule 13d-1(d) after the year-end, the investor would instead file under Rule 13d-1(b), 13d-1(c) or file a Schedule 13D, as appropriate.

(i) The initial Schedule 13G filing is required within 45 days of the end of the calendar year if beneficial ownership exceeds 5 percent as of the end of the calendar year.

(ii) Amendments are required within 45 days of the end of the calendar year if, as of Dec. 31, there is any change in the information previously reported (unless the only change is a change in the percentage beneficially owned and such change is a result of a change in the number of shares of the class outstanding).

C. Section 16 Reporting Requirement Trigger

1. Upon becoming an officer, director[5] or greater than 10-percent "beneficial owner" of any subject security

2. "Beneficial ownership" for determining who is subject to Section 16 is, for the most part, the same as the Section 13(d) beneficial ownership determination. Therefore a Schedule 13D/G filer that is a greater than 10-percent beneficial owner separately will be subject to Section 16 reporting. Accordingly, reporting persons are typically the same as under the Section 13(d) analysis.

D. What Is Reported and Subject to Matching Under Section 16(a)?

1. The beneficial ownership test used to determine whether a person is subject to Section 16 as a greater than 10-percent beneficial owner is different from the test used to determine what is reported under Section 16(a) and what is subject to matching for purposes of Section 16(b). Section 16(a) requires the disclosure of, and Section 16(b) subjects to profit disgorgement under Section 16, any equity securities of the issuer in which the reporting persons have a direct or indirect "pecuniary interest" (discussed below).

2. The use of different tests for determining greater than 10-percent beneficial ownership on the one hand and what is included on Section 16 reports on the other hand can result in a filer not reporting securities that were taken into account when determining whether the filer was subject to Section 16. It can also result in securities that are reported under Section 16 being excluded from Section 13(d) reporting and vice versa.

3. Pecuniary interest is defined as the "opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities" (Rule 16a-1(a)(2)(i)).

---

[4] This comes up most often where an issuer's securities are held, such as by a private equity or venture capital fund, prior to the issuer's initial public offering (concurrently with which the securities will become registered under the Exchange Act).

[5] It is possible for an entity to be treated as a director for purposes of Section 16 if it can be shown that the entity has deputized an individual to sit on the board of an issuer in order to represent the interests of the entity. If an entity is deemed to be a director-by-deputization, the entity will be treated as a director and subject to Section 16 as such regardless of whether the entity beneficially owns more than 10 percent of the issuer's securities.

© 2016 Schulte Roth & Zabel LLP

(a) An indirect pecuniary interest is defined to include a general partner's proportionate interest in the portfolio securities held by a general or limited partnership to the extent of the greater of the partner's share of the partnership's profits or capital account (Rule 16a-1(a)(2)(ii)(B)).

(b) An investment manager will have an "indirect pecuniary interest" with respect to a class of an equity security if it receives a performance fee based, in part, on the security's performance *unless*, with respect to the performance fee: (i) the performance fee is calculated over a period of one year or more; and (ii) the equity securities of the issuer do not account for more than 10 percent of the market value of the portfolio of the applicable fund or account (Rule 16a-1(a)(2)(ii)(C)).[6]

(c) Asset-based fees are excluded from the definition of indirect pecuniary interest (Rule 16a-1(a)(2)(ii)(C)).

(d) A Fund will be deemed to have a direct pecuniary interest in any securities directly held by it.

4. Forms Filed Under Section 16(a)

(a) Form 3 – Initial Statement of Beneficial Ownership of Securities: Must be filed within 10 days of becoming an officer, director or greater than 10-percent "beneficial owner" to report all equity securities in which the filer has a pecuniary interest as of the time of crossing 10 percent (except that if the filing is a result of the initial registration of the issuer's securities under the Exchange Act (e.g., in connection with an IPO) the filing is required to be made on the date the issuer's registration statement is declared effective by the SEC).

(b) Form 4 – Statement of Change of Beneficial Ownership of Securities: Must be filed within two business days after a change in pecuniary interest takes place.

(c) Form 5 – Annual Statement of Beneficial Ownership of Securities: Must be filed within 45 days of the issuer's fiscal year end to report transactions that took place in the prior year that should have been reported but were not. It can also be used to report certain transactions exempt from 16(b). If there are no transactions required to be filed on a Form 5, no such filing is made for the year.

5. Section 16(b) Short-Swing Profit Liability

(a) Section 16(b) imposes liability for short-swing profits from the issuer's equity securities (including derivative securities) upon all persons required to file reports under Section 16(a).

(b) Section 16 insiders must disgorge to the issuer any profits realized as a result of a purchase and sale or sale and purchase of any equity securities of the issuer within a period of less than six months ("short-swing profits").

(c) With respect to 10-percent beneficial owners, the purchase that puts the beneficial owner over the 10-percent threshold does not qualify as a "purchase" subject to Section 16(b); only purchases made after becoming a greater than 10-percent beneficial owner will give rise to short-swing profits when matched against sales occurring within six months and while a Section 16 insider.

[6] The determination of "market value" is not defined. A factor that can be relevant to the determination includes how the Fund or account carries the position on its books.

© 2016 Schulte Roth & Zabel LLP

(d) The "lowest-in, highest-out" method of calculating matching transactions is used to calculate profits under Section 16(b). Under this approach, "the highest sale price during the six month period is matched against the lowest purchase price in that period, followed by the next highest sale price and next lowest purchase price and so on, until all shares have been included" irrespective of the order in which the transactions were executed. Under this approach, it is possible for an insider to have an actual loss but a "realized" profit that is payable under Section 16(b).

Example

Transactions Investment Status	
Transaction 1: Buy 1,000,000 shares at $10 ($10M)	$10,000,000
Transaction 2: Buy 1,000,000 shares at $20 ($20M)	$30,000,000
Transaction 3: Sell 1,000,000 shares at $20 ($20M)	$10,000,000
Transaction 4: Sell 1,000,000 shares at $5 ($5M)	$5,000,000
Total Loss = $5,000,000	

Under §16(b)
Lowest price in = $10 = $10,000,000
Highest price out = $20 = $20,000,000
Total Realized Profit = $10,000,000

III. Rule 14e-4: The Short Tender Rule

A. Rule 14e-4 Generally

1. Rule 14e-4 prohibits a person from tendering shares into a partial tender offer unless the person is "net long" both at the time of tender and at the end of the proration period of the tender offer. Under Rule 14e-4(a)(1) a person's "net long position" is the excess, if any, of its "long position" over its "short position."

2. In adopting Rule 14e-4 (which at the time was Rule 10b-4; it was designated as Rule 14e-4 in 1990), Congress indicated that its intention was for each shareholder to receive equal treatment based upon the shareholder's interest in the securities that are the subject of a tender offer. By short tendering or hedging their tender, market professionals reduce their proration risk while increasing the proration risk of all those who cannot short or engage in hedged tendering, because the short or hedged tendering often leads to over tendering (i.e., the same shares being tendered more than once). The SEC has observed that short and hedged tendering often requires access to borrowed shares, which market professionals have a clear advantage in obtaining access to.[7]

B. Things to Note When Calculating a Person's Long and Short Positions

1. Rule 14e-4(a)(1)(i) defines a person's long position to include the amount of subject securities that such person:

(a) Or his agent has title to or would have title to but for having lent such securities; or

[7] *See* Release No. 34-26609 (March 8, 1989).

© 2016 Schulte Roth & Zabel LLP

(b) Has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase but has not yet received; or

(c) Has exercised a *standardized* call option for; or

(d) Has converted, exchanged, or exercised an equivalent security for; or

(e) Is entitled to receive upon conversion, exchange or exercise of an equivalent security.

2. Rule 14e-4(a)(1)(ii) defines a person's short position to include the amount of subject securities that such person:

(a) Has sold, or has entered into an unconditional contract, binding on both parties thereto, to sell; or

(b) Has borrowed; or

(c) Has written a *non-standardized call option*, or granted any other right pursuant to which his shares may be tendered by another person; or

(d) Is obligated to deliver upon exercise of a *standardized* call option *sold on or after the date that a tender offer is first publicly announced* or otherwise made known by the bidder to holders of the security to be acquired, *if* the exercise price of such option is lower than the highest tender offer price or stated amount of the consideration offered for the subject security. For the purpose of this paragraph, if one or more tender offers for the same security are ongoing on such date, the announcement date shall be that of the first announced offer.

IV. Derivatives Update

A. Margin Requirements for Non-Cleared Swaps

1. A final rule was adopted by a group of banking regulators (the "prudential regulators") on Oct. 22, 2015 establishing minimum margin requirements for non-cleared swaps and non-cleared security-based swaps.[8] The rule generally requires dealers to collect and post initial margin with a limited set of counterparties and collect and post variation margin with all others (subject to limited exceptions). The CFTC is expected to issue its own rule for margining non-cleared swaps in the near future.

2. The final rule imposes requirements depending on: (i) whether the relevant entity is a "Financial End User," and (ii) whether such entity has a "Material Swaps Exposure."

(a) The term Financial End User is broadly defined to cover various forms of investment funds, including: (i) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940; (ii) an entity that is deemed not to be an investment company under Section 3 of the Investment Company Act of 1940 pursuant to Rule 3a-7; and (iii) a commodity pool, commodity pool operator or commodity trading advisor.

[8] *See* Final Rule to Establish Margin and Capital Requirements for Covered Swap Entities (unofficial text) (the "Final Rule"). The Final Rule was jointly adopted by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration and the Federal Housing Finance Agency. For ease of reference, the term "swaps" as used herein will refer to both "swaps" and "security-based swaps" unless the context requires otherwise.

© 2016 Schulte Roth & Zabel LLP

(b) An entity has Material Swaps Exposure if it and its affiliates have an average daily aggregate notional amount of non-cleared swaps with all counterparties for business days in June, July and August of the previous calendar year that exceeds $8 billion.[9] Managers likely will be required to represent to dealers whether any fund has a Material Swaps Exposure.

3. Margin Requirements

(a) Initial Margin: Dealers must both collect and post initial margin for swaps entered into with Financial End Users that have a Material Swaps Exposure. Dealers are permitted to apply a threshold of up to $50 million, an exposure below which will not require the exchange of initial margin. Dealers do not have any obligation to collect or post initial margin with non-Financial End Users or Financial End Users without a Material Swaps Exposure. Initial margin may be calculated either by a dealer's pre-approved proprietary model or by using a standardized margin schedule set forth in the final rule. Initial margin collected in excess of the $50-million threshold must be segregated with a third-party custodian.

(b) Variation Margin: Dealers are generally required to collect and post variation margin for all swaps entered into with a Financial End User regardless of material swaps exposure (and without any permissible threshold amount).

(c) Eligible margin types include immediately available cash funds denominated in any major currency or certain types of non-cash collateral subject to a fixed haircut based on asset class.

(d) Parties to an eligible master netting agreement ("EMNA") are generally permitted to calculate initial margin and variation margin on an aggregate net basis across all non-cleared swaps. Parties to an EMNA can elect to maintain a separate set of legacy swaps executed prior to the applicable compliance date that will not be subject to the margin rules.

4. Compliance Dates

The initial margin rule will be phased in between Sept. 1, 2016 and Sept. 1, 2020 depending on the swap activity levels of the two counterparties. Variation margin requirements begin Sept. 1, 2016 for entities with high average daily notional exposure, and March 1, 2016 for all other counterparties.

B. CFTC Aggregation Rules – 2015 Update

1. In September 2015 the CFTC issued proposed modifications to its 2013 proposed rules on position limit aggregation in Part 150 of the CFTC Regulations (The "2015 Proposal" and "2013 Proposal" respectively).[10] Both proposals generally require a person or owner (an "owner") to aggregate its own positions with any account or entity that is not a pooled investment vehicle in which such person has a 10-percent or greater ownership or equity interest (an "owned entity").[11] The proposed

[9] The term "affiliate" is defined to mean entities that are consolidated on the same financial statements prepared in accordance with GAAP (or similar foreign standards) and is unlikely to include two funds separately managed by the same investment manager. Where the assets of an investment fund are consolidated with the assets of its investment manager, such as during seeding, the entities would be considered affiliated for purposes of the final rule.

[10] CFTC Supplemental Notice of Proposed Rulemaking: Aggregation of Positions, 80 Fed. Reg. 58365 (Sept. 29, 2015); CFTC Notice of Proposed Rulemaking: Aggregation of Positions, 78 Fed. Reg. 68946 (Nov. 15, 2013).

[11] Certain aspects of these aggregation rules and their exemptions are already currently applicable.

position limit rules apply to many futures and options contracts as well as economically equivalent swaps.[12]

2. The 2013 Proposal permitted the disaggregation of positions held by owned entities in the following scenarios:

    (a) An owner that meets certain requirements and who owns between 10 percent and 50 percent of an owned entity may disaggregate positions by filing a notice with the CFTC.

    (b) An owner meeting the same requirements and who owns greater than 50 percent of an owned entity may disaggregate positions only with prior approval from the CFTC.

3. The 2015 Proposal removed the distinction between scenarios described in 2(a) and 2(b) above so that, subject to the below requirements, any owner who owns greater than 10 percent of an owned entity may disaggregate positions by filing a notice with the CFTC. The requirements are as follows:

    (a) No knowledge of the trading decisions of the other.

    (b) The entities trade pursuant to separately developed and independent trading systems.

    (c) The entities have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about trades of the other.

    (d) The entities do not share employees who control the trading decisions of either.

    (e) The entities do not have risk management systems that permit the sharing of trades or trading strategies.

4. The 2015 Proposal did not modify the 2013 Proposal's requirement that two entities with substantially identical trading strategies must aggregate regardless of whether an exemption would apply.

V. Spoofing

A. What Is Spoofing?

"Spoofing" is defined as "bidding or offering with the intent to cancel the bid or offer before execution."

B. Spoofing Is Unlawful.

1. Spoofing is prohibited by several statutes and regulations, primarily by the anti-spoofing provision of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 747 of the Act added to Section 6c(a) of the Commodity Exchange Act that: "It shall be unlawful for any person to engage in any trading, practice or conduct on or subject to the rules of a registered entity that … is, is of the character of, or is commonly known to the trade as, 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution)."

2. The Chicago Mercantile Exchange ("CME") also prohibits spoofing under Rule 575, Disruptive Practices Prohibited:

[12] For pooled investment vehicles, aggregation is generally for investors who have a 25-percent or greater ownership in a vehicle where its manager relies on the CFTC Rule 4.13(a)(3) exemption from registration as a commodity pool operator.

© 2016 Schulte Roth & Zabel LLP

(a) "No person shall enter or cause to be entered an order with the intent, at the time of order entry, to cancel the order before execution or to modify the order to avoid execution;

(b) No person shall enter or cause to be entered an actionable or non-actionable message or messages with intent to mislead other market participants."

C. Both the SEC and DOJ have shown a new interest in pursuing spoofing cases, evidenced by the first-ever criminal conviction for spoofing, and various other civil and criminal cases and settlements involving spoofing.

1. *United States v. Coscia*, No. 14-cr-00551 (N.D. Ill. Nov. 3, 2015) represented the first-ever criminal charge and conviction for spoofing. Michael Coscia, a high-frequency trader, was convicted for manipulating commodity future contract markets that were part of CME Group Inc. (including the CME, the Chicago Board of Trade, the New York Mercantile Exchange, and Commodity Exchange Inc.). Coscia traded on various CME Group Markets and ICE Futures Europe, a futures exchange based in London. Coscia would enter large-volume orders and immediately cancel them before they could be executed. The large non-bona fide orders would create a false impression and cause the market to act in a way that allowed Coscia to profit off of bona fide trades in the opposite direction. Coscia also utilized computer programs to implement this scheme, which automatically canceled certain orders and also looked for favorable market conditions such as price stability, low volume at the best price, and narrow bid-ask spreads. Coscia's spoofing also took another form. He would place a series of buy and sell orders in which he would purchase futures contracts in the Euro FX market at a deflated price and immediately sell them for a profit. For example, Coscia would place a small buy order at a price below market price, then place multiple large sell orders to drive the price down and cause his buy order to be executed, and then would immediately close his open sell orders. Coscia would follow that by doing the same thing in the opposite direction, placing one small sell order at above market price and then several large buy orders to drive the price up. After the sell order was executed, Coscia would cancel the buy orders. Coscia could accomplish this whole series of transactions in less than one second. Coscia was convicted on six counts of market manipulation and six counts of spoofing. Sentencing is scheduled for 2016. Coscia also settled a case with the CFTC by agreeing to pay $2.8 million and serve a one-year trading ban without admitting or denying any of the charges.

2. *In the Matter of Behruz Afshar et al.*, Release No. 9983 (Dec. 3, 2015): On Dec. 3, 2015, the SEC charged three individuals with, among other things, perpetrating a spoofing scheme to earn liquidity rebates from the Nasdaq OMX PHLX (the "PHLX"). The respondents allegedly placed bona fide large all-or-none orders (orders that were undisplayed and must be executed in their entirety or not at all) in order to collect a rebate the PHLX offered for orders that created liquidity (as part of its "maker-taker" fee model). The respondents would then spoof the market into executing the large all-or-none orders by placing smaller non-bona fide orders in the same option and at the same price, but on the opposite side. These smaller non-bona fide orders would alter the option's best bid or offer to "spoof" the market into submitting orders at the new best bid or offer to execute the all-or-none order. The respondents then would cancel any open orders. Allegedly, the respondents collected over $225,000 through this spoofing scheme.

3. *United States v. Milrud*, No. 2:15-cr-00455 (Sept. 10, 2015); *SEC v. Milrud*, No. 15-CV-00237 (D.N.J. Jan. 13, 2015): Aleksandr Milrud has simultaneous criminal and civil cases being pursued against him for securities fraud, specifically spoofing. Milrud allegedly orchestrated a spoofing scheme that involved recruiting overseas-based traders, whom he would instruct to place corresponding bona fide and non-bona fide trades in order to earn an illegal profit. Specifically, the traders would place numerous orders in one direction for a certain stock, progressively lowering or increasing the price

© 2016 Schulte Roth & Zabel LLP

in small increments (usually a penny) to increase or decrease the stock price. Milrud took certain steps in an attempt to conceal the spoofing scheme, including giving each trader two accounts (one for bona fide trades and one for non-bona fide trades) and keeping profits intentionally low on each stock. The civil case is currently stayed, but in the criminal case Milrud recently agreed to plead guilty to one count of conspiracy to commit securities fraud in violation of 18 U.S.C. § 371.

4. *United States v. Sarao*, No. 15-cr-00075 (N.D. Ill. April 21, 2015): In a spoofing case related to the "Flash Crash" on May 6, 2010, Navinder Singh Sarao was charged with wire fraud, commodities fraud, commodities manipulation and spoofing. Sarao allegedly would place multiple non-bona fide large volume orders at different price points on the CME for the E-Mini S&P 500, a futures contract based on the S&P 500. The orders would fraudulently cause the market to react by selling E-Mini, causing the price to fall. Sarao used automated trading functions and programs to minimize the risk of actually executing his non-bona fide orders by ensuring that his offers were never the best offer available. The SEC described Sarao's strategy as a "dynamic layering technique" whereby he would almost constantly modify his non-bona fide offers to stay slightly below the market or best price. As Sarao caused the market to move downward, he would repeatedly sell futures contracts and then buy them back at a lower price. As the price moved back upward, Sarao would do the opposite and repeatedly buy futures contracts and then sell them at a higher price. In addition to his primary fraudulent scheme, Sarao would also flash large non-bona fide orders and then place smaller bona fide orders in the opposite direction.

5. *In the Matter of Briargate Trading, LLC and Eric Oscher*, Release No. 9959 (Oct. 8, 2015): A trading firm and one of its principals were charged with utilizing spoofing to manipulate the market. Specifically, the respondents allegedly placed non-bona fide orders on the NYSE, placed bona fide orders in the opposite direction away from the NYSE, and then cancelled the non-bona fide orders all before the market opened. These pre-opening orders would be disseminated through Order Imbalance Messages before the market opened, causing the opening price of a stock to change and allowing the respondents to earn profits on the bona fide orders. The respondents were charged with violating Section 17(a) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Briargate ultimately settled the case, agreeing to pay a civil money penalty of $350,000. Oscher also settled and agreed to pay a $150,000 civil money penalty. The respondents jointly agreed to pay disgorgement of $525,000 and prejudgment interest of $37,842.32. There were no bars or trading suspensions, and the respondents did not admit or deny any of the SEC's findings, except Oscher admitted the findings as true for the sole purpose of Section 523 of the Bankruptcy Code.

VI. Enforcement: Shareholder Activism

A. The SEC has been showing increased attention and interest in shareholder activism. For example, both Chair White and Commissioner Gallagher have recently spoken about activism, its benefits and harms, and the role of the SEC in addressing activism.[13]

B. The SEC has not publicized any activist-focused enforcement decisions, but that does not mean the SEC is not investigating certain activist behavior. In fact, media reports indicate that SEC is investigating certain activist behavior.

C. Although there are various enforcement risks that activists in particular face, acting as a group is one of, if not the, most noteworthy and most of interest to the SEC.

[13] *See* Daniel M. Gallagher, SEC Commissioner, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors College (June 23, 2015); Mary Jo White, SEC Chair, A Few Observations on Shareholders in 2015 (March 19, 2015) (discussing in part the current activism landscape).

© 2016 Schulte Roth & Zabel LLP

1. Commissioner Gallagher, while discussing the SEC's role with activist hedge funds, recently stated: "The most obvious issue presented to the Commission is the Section 13 reporting obligations that we administer."[14]

2. Section 13(d) deems two or more persons to qualify as a single person for the purposes of reporting under Section 13(d) when they act "as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer."

3. The U.S. Court of Appeals for the Second Circuit has held that "the touchstone of a group within the meaning of section 13(d) is that the members combined in furtherance of a common objective."[15]

4. A recent *Wall Street Journal* article reported that the SEC is conducting multiple investigations into whether some activist investors acted as a group without adequately reporting under Section 13(d).[16] Specifically, the article stated that the SEC had sent a letter to an activist fund inquiring as to whether the fund had any "agreements or understandings" with another fund that was orchestrating its own proxy contest against the same target company.

VII. New Enforcement Initiatives in the Futures and Options World

A. Recent history demonstrates a new willingness on the part of the futures and options exchanges to assert enforcement actions against market participants.

B. This trend is most notable when reviewing recent actions by the CME Group market regulation division.

   1. In recent years, the CME has made a number of enforcement hires in its New York and Chicago offices. Many of these new hires are former criminal prosecutors and defense lawyers who know how to try cases and take them through a trial.

   2. CME enforcement actions that involve market manipulation (including spoofing) are headline events (Attachment A).

   3. However, at the same time, CME enforcement of other rule violations, including technical violations that may not evidence scienter, has increased. Enforcement actions have focused on position limit violations, non-bona fide exchanges for related products ("EFRPs"), transitory EFRPs and improper futures for futures exchanges. For many of these matters, the interpretation of the CME rules is very technical and may be non-intuitive.

   4. Market participants can find themselves on the receiving end of an enforcement inquiry or action even if they are exempt from CFTC registration. Market-level enforcement is triggered by trading, not by any registration or other regulatory status.

---

[14] Daniel M. Gallagher, SEC Commissioner, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors College (June 23, 2015).

[15] *Roth v. Jennings*, 489 F.3d 499, 508 (2d Cir. 2007 (quoting *Wellman v. Dickinson*, 682 F.2d 355, 363 (2d Cir. 1982)).

[16] Liz Hoffman, Aruna Viswanatha and David Benoit, "SEC Probes Activist Funds over Whether They Secretly Acted in Concert," *The Wall Street Journal* (June 14, 2015).

VIII. New Developments in the Market Abuse Regime in Europe

A. Market Abuse Regulation: The Market Abuse Regulation (part of the MAD II legislative package) ("MAR") will enter into force in EU member states on July 3, 2016. The key changes introduced by MAR include:

1. Broadening the scope of financial instruments covered by the market abuse regime to include any financial instruments admitted to trading on a multilateral trading facility or organized trading facility (i.e., a new type of trading venue to be introduced by MIFID II) and any instruments the price or value of which depends, or has an effect, on any such financial instrument (e.g., CDS);

2. Inclusion of emission allowances and related auctioned products within the scope of MAR;

3. Inclusion of spot commodity contracts within the scope of the prohibition against market manipulation where the behavior is likely to have an effect on the price of commodity derivatives within the scope of MAR;

4. The widening of the existing market manipulation offence and the creation of a new offence of "attempted market manipulation";

5. A new regime for reporting suspicious transactions and orders;

6. A new framework for disclosures of inside information in the course of taking market soundings; and

7. A new whistleblowing (to the regulator) and administrative sanctions regime.

B. There has been increased scrutiny of insider dealing and market manipulation by the FCA in the United Kingdom. Recent FCA enforcement actions have focused on insider dealing, improper disclosure of inside information, market manipulation and failure to report a suspicion of market abuse.

IX. ERISA Provisions in Trading Documents

A. ERISA issues often arise, even for non-plan asset funds, in the various trading documents into which a hedge fund enters, such as the Prime Brokerage Agreement, ISDAs, Master Repo Agreements, Master Securities Loan Agreements, FX Prime Brokerage Agreements, Master Futures Agreements, etc., because these documents will almost assuredly contain ERISA representations.

B. The base line starting point is typically a no-plan-asset and no-prohibited-transaction representation and warranty given by the hedge fund and its investment manager. This language is likely to be set forth in the trading documents even if the hedge fund is intended to be a plan asset fund, unless the investment manager's personnel impress on the counterparty that the hedge fund will be a plan asset fund.

C. In a non-plan asset fund, the trading documents will typically contain representations that the assets of the fund are not plan assets, that entering into the agreement does not give rise to a prohibited transaction under ERISA and that the effecting of individual transactions under the agreement does not give rise to a prohibited transaction under ERISA.

© 2016 Schulte Roth & Zabel LLP

D. These representations are legitimate requests, but the key is to attempt to negotiate the agreement in such a way that a violation of the representation should not give rise to a default or an additional termination event unless there is, in fact, a prohibited transaction.

E. In reality, even if the investment manager is not a "qualified professional asset manager" as defined under the Department of Labor's QPAM Exemption and the fund slips into plan asset status by accident, neither entering into the master agreement, nor into any individual transactions thereunder, will give rise to a prohibited transaction because Section 408(b)(17) of ERISA (the so-called "service provider exemption") should exempt these activities as long as the pricing of the transaction is "right." The service provider exemption is available regardless of whether the hedge fund intends to be a plan asset vehicle and even if the hedge fund's governing documents affirmatively stated that the hedge fund will not be a plan asset vehicle.

F. The pricing should always be "right" because the individuals negotiating the documents and causing the individual transactions on behalf of the hedge fund are investment professionals with a strong grasp of the market pricing. Thus, it should be difficult for anyone to argue that the counterparty "pulled the wool" over the investment manager's eyes in connection with any particular transaction, rendering the service provider exemption unavailable.

G. Note the one exception to the availability of the service provider exemption. It is not available if the counterparty caused one of the plans to invest in the particular hedge fund.

H. For a plan asset fund, the counterparty will typically require the hedge fund and the investment manager to represent that the investment manager is a "qualified professional asset manager" within the meaning of the DOL's QPAM Exemption.

I. Normally this should not be an issue, as the investors will also require that the investment manager be a QPAM.

J. Although it may be possible to conduct all of the hedge fund's transactions using the service provider exemption, it is much more difficult negotiating for such a provision with various of the counterparties. Even if this goal is attainable, the counterparties will pick and choose the transactions for which they will agree to use the service provider exemption. Further, because of a DOL Advisory Opinion, the service provider exemption will typically not be available in connection with cleared swaps. No such limitations should be expected when the investment manager is a QPAM.

K. Some counterparties will negotiate the ERISA provisions so that the investment manager can either be a QPAM or rely on the service provider exemption. This is particularly important if a plan asset fund intends to enter into repos, as the DOL has declared that the QPAM Exemption is not available for repo transactions and the QPAM Exemption by its terms does not apply to securities-lending transactions.

© 2016 Schulte Roth & Zabel LLP

Attachment A: Selected CME Enforcement Settlements with Buy-Side Market Participants

(October 2013 Through October 2015)

Date	Violator	Alleged Facts of Settlement	Remedies
10/2/15	BBL Commodities LP	Violated Rule 562 by holding a futures equivalent position in excess of the standard expiration month limit by 1,553 contracts (38.83%)	Fine of $25,000; disgorgement of $195,384.40
8/21/15	Blenheim Capital Mgmt. LLC	Violated Rule 538.H with insufficient documentation of two EFRPs	Fine of $10,000
7/24/15	Pac. Inv. Mgmt. Co.	Violated Rule 562 by holding end-of-day net short positions in excess of the single-month position limit by 44 contracts (0.676%) and in excess of the all-months position limit by 375 contracts (5.769%); and by holding end-of-day net short positions in excess of the single-month position limit by 107 contracts (1.646%) and the all-months position limit by 1,090 contracts (16.769%)	Fine of $35,000
6/1/15	Hayman Capital Mgmt. LP	Violated Rule 562 by holding a long position in excess of the standard expiration month limit by 300 contracts (43.33%)	Fine of $25,000; disgorgement of profits of $709,270
4/17/15	SummerHaven Inv. Mgmt. LLC	Violated Rule 538.H with insufficient documentation of one EFRP	Fine of $7,500
4/17/15	Daniel Shak (SHK Asset Mgmt.)	Violated NYMEX Legacy Rule 443 by exceeding accountability limits for three days	Fine of $25,000
3/23/15	Citadel Sec. LLC	Violated CME Rule 432.Q when, because of a software malfunction, it entered a series of unintentional orders on the Globex platform, which caused an atypical short-term increase in trading volume and affected prices	Fine of $70,000
12/19/14	Rahul Seksaria (PIMCO)	Violated Rules 432.G, 432.Q, 539.A by orchestrating trades in futures contracts opposite one of his employer's client suspense accounts	Fine of $65,000; restitution of $2,675; suspension from all CME platforms for three months
10/27/14	Sun Life Fin. Inc.	Violated Rules 432.W, 534 by executing two trades totaling 989 contracts on both sides of the transactions; firm also failed diligently to supervise its employees	Fine of $50,000
9/25/14	Weidong Ge (Shanghai Chaos)	Violated Rules 534, 432.W by directing traders on two occasions to execute wash trades and by failing diligently to supervise them	Fine of $35,000 Fine of $15,000
8/15/14	Vermillion Asset Mgmt. LLC	Violated Rule 538.H with insufficient documentation of EFRPs	Fine of $20,000
7/3/14	EMF Fin. Prods. LLC	Violated Rule 538 by inaccurately reporting transactions as EFRPs and by failing to ensure proper documentation for EFRPs	Fine of $12,500 Fine of $12,500
6/16/14	RCG Holdings LLC	Violated Rule 562 by holding a position in excess of the standard expiration month limit by 81 contracts (8.1%)	Fine of $15,000; disgorgement of $5,482.68

Date	Violator	Alleged Facts of Settlement	Remedies
5/2/14	Ontario Teachers' Pension Plan Bd.	Violated Rule 562 by holding positions in excess of the single month speculative position limit by 2.1% and 2.6%	Fine of $15,000; disgorgement of $17,899.82
5/1/14	D.E. Shaw & Co. LP	Violated Rule 562 by holding a position in excess of standard position limit by 807.5 contracts (80.75%)	Fine of $75,000
		Violated Rule 562 by simultaneously holding financial contracts and physical contracts	Fine of $25,000
2/7/14	Vermillion Asset Mgmt. LLC	Violated Rule 562 by simultaneously holding financial contracts and physical contracts	Fine of $45,000
		Violated Rule 562 by simultaneously holding financial contracts and physical contracts	Fine of $35,000
2/7/14	GMT Capital Corp.	Violated Rule 562 by holding a position in excess of the standard expiration month limit by 1,555 contracts (155.50%)	Fine of $40,000; disgorgement of $8,820
12/23/13	Iken Capital LLP	Violated Rules 432.Q and 432.W by failing adequately to monitor its auto-spreader	Fine of $90,000
10/24/13	Karya Capital Mgmt. LP	Violated Rule 562 by holding an aggregate intraday long position in excess of the all contract months combined speculative position limit by 261 contracts (5%); then by 64 contracts (1%); then by 264 contracts (5%)	Fine of $10,000, and disgorgement of $166,325, in connection with first violation; fined $30,000 in connection with latter two violations
9/30/13	Cypress Energy Capital Mgmt. LP	Violated Rule 562 by holding a short position in excess of the expiration month limit by 77 contracts (7.7%)	Fine of $15,000; disgorgement of $5,900
9/24/13	AQR Capital Mgmt. LLC	Violated Rule 562 by holding a position in excess of the single month speculative position limit by 323 contracts (2%); firm had violated position limit rules twice before within seven-month period	Fine of $70,000; disgorgement of $925

This information and any presentation accompanying it (the “Content”) has been prepared by Schulte Roth & Zabel LLP (“SRZ”) for general informational purposes only. It is not intended as and should not be regarded or relied upon as legal advice or opinion, or as a substitute for the advice of counsel. You should not rely on, take any action or fail to take any action based upon the Content.

As between SRZ and you, SRZ at all times owns and retains all right, title and interest in and to the Content. You may only use and copy the Content, or portions of the Content, for your personal, non-commercial use, provided that you place all copyright and any other notices applicable to such Content in a form and place that you believe complies with the requirements of the United States' Copyright and all other applicable law. Except as granted in the foregoing limited license with respect to the Content, you may not otherwise use, make available or disclose the Content, or portions of the Content, or mention SRZ in connection with the Content, or portions of the Content, in any review, report, public announcement, transmission, presentation, distribution, republication or other similar communication, whether in whole or in part, without the express prior written consent of SRZ in each instance.

This information or your use or reliance upon the Content does not establish a lawyer-client relationship between you and SRZ. If you would like more information or specific advice on matters of interest to you please contact us directly.

© 2016 Schulte Roth & Zabel LLP. All Rights Reserved.

Schulte Roth & Zabel
New York | Washington DC | London
www.srz.com