

## Investment Management Regulatory Update

April 29, 2013

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## SEC Rules and Regulations

### CFTC and SEC Adopt Identity Theft Rules

On April 10, 2013, the Commodity Futures Trading Commission (the “**CFTC**”) and the Securities and Exchange Commission (the “**SEC**,” and together with the CFTC, the “**Commissions**”) issued final rules and guidelines (the “**Rules**”) that will require “financial institutions” and certain “creditors” that fall under their respective jurisdictions (including commodity pool operators, commodity trading advisors, registered broker-dealers, registered investment companies (“**RICs**”), business development companies, employees’ securities companies and registered investment advisers) and that offer or maintain “covered accounts,” to develop written identity theft prevention programs. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commissions were added to the list of federal agencies that are required to issue rules to prevent identity theft. The Rules are substantially similar to final rules and guidelines that were issued jointly in 2007 by the Office of the Comptroller of the Currency, the Federal Reserve and other agencies, and are substantively similar to the rules proposed by the Commissions on February 28, 2012, as previously discussed in the [March 21, 2012 Investment Management Regulatory Update](#) and the March 7, 2012 Davis Polk Client Memorandum, [CFTC and SEC Jointly Propose Identity Theft Rules](#). In their adopting release, the Commissions noted that it is likely that most of the financial institutions and creditors covered by the Rules already comply with the existing rules regarding identity theft prevention, and therefore may only be required to supplement programs already in place.

**Financial Institutions.** The Commissions defined “financial institution” in the Rules by reference to the definition of such term in the Fair Credit Reporting Act of 1970 (“**FCRA**”), which includes an entity that directly or indirectly holds a transaction account belonging to an individual. In this context, “transaction account” includes an “account on which the . . . account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others.” According to the Commissions’ adopting release, the definition specifically includes (i) a broker-dealer that offers custodial accounts, (ii) a RIC that allows investors to make wire transfers to others or offers check-writing privileges and (iii) an investment adviser that directly or indirectly holds transaction accounts and that is allowed to direct payments or transfers out of such accounts to third parties. According to the Commissions’ adopting release, an adviser that only has authority to withdraw money from an investor’s account to obtain advisory fees would not hold a “transaction account,” since payments would not be made to a third party.

**Creditors.** The Commissions also defined “creditor” in the Rules by reference to the definition of such term in the FCRA, which includes a creditor, as defined in the Equal Credit Opportunity Act, that “regularly and in the course of business . . . advances funds to or on behalf of a person, based on an obligation of the person to repay,” excluding funds for incidental services provided by the creditor. According to the Commissions’ adopting release, an adviser to a private fund would not be considered a creditor solely because its private funds regularly borrow money from third-party creditors, since the definition of “creditor” does not include indirect creditors.

**Covered Accounts.** Under the Rules, financial institutions and creditors are only required to implement an identity theft program if they offer or maintain “covered accounts.” The Rules define “covered accounts” as “(i) an account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions; and (ii) any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.” The Rules require that financial institutions and creditors periodically determine whether they are maintaining or offering covered accounts.

Financial institutions and creditors that offer or maintain covered accounts are required to implement a written identity theft prevention program (a “**Program**”) that is designed to detect, prevent and mitigate identity theft in connection with the opening and maintenance of covered accounts. A program must be reasonably designed to:

- identify and incorporate into the Program “red flags” (defined as patterns, practices or activities that indicate the possible existence of identity theft);
- detect the existence of red flags incorporated into the Program;
- appropriately respond to detected red flags in order to prevent and mitigate identity theft; and
- update the Program periodically to reflect changes in risks of identity theft to customers and to the safety and soundness of the financial institution or creditor.

The Commissions’ adopting release also includes guidelines that entities must consider when implementing and administering any Program, which generally give instructions on how to identify red flags.

In addition, the Rules generally require, among other things, (i) board approval of the initial written Program, (ii) senior level oversight of its development, implementation and administration, (iii) annual compliance reports, (iv) staff training to effectively implement the Program and (v) steps to ensure that any service providers performing activities in connection with covered accounts employ reasonable policies and procedures designed to detect, prevent and mitigate the risk of identity theft.

The Rules will become effective on May 20, 2013 and must be complied with by November 20, 2013.

- ▶ [See a copy of the Commissions' adopting release](#)
- ▶ [See a copy of the SEC press release](#)

## SEC Staff Responds to Inquiries About Filing Requirements for Certain Electronic Communications

On March 15, 2013, the Division of Investment Management of the SEC issued an IM Guidance Update to address inquiries regarding whether certain electronic communications posted by mutual funds and other investment companies in real-time forums (such as chat rooms or other social media) should be filed under the filing requirements of Section 24(b) of the Investment Company Act of 1940, as amended (the "**Investment Company Act**") or Rule 497 under the Securities Act of 1933 (the "**Securities Act**") if such communications are not required to be filed under Financial Industry Regulatory Authority ("**FINRA**") Rule 2210. Section 24(b) of the Investment Company Act prohibits certain investment companies from transmitting any "advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors" unless the transmitted material is filed with the SEC. In addition, Rule 497 under the Securities Act requires registered investment companies and business development companies to file with the SEC advertisements and other sales material that are subject to Rule 482 under the Investment Company Act. In both cases, these SEC-filing requirements can generally be satisfied by filing the materials with FINRA.

According to the IM Guidance Update, the SEC staff believes that certain interactive content does not need to be filed and stated that "[w]hether a communication need be filed depends on the content, context, and presentation of the particular communication or set of communications and requires an examination of the underlying substantive information transmitted to the social media user and consideration of any other facts and circumstances, such as whether the interactive communication is merely a response to a request or inquiry from the social media user or is forwarding previously-filed content." The IM Guidance Update provides several examples of electronic communications that the SEC staff believes would not trigger a filing requirement. According to the IM Guidance Update, (i) "[a]n incidental mention of a specific investment company . . . not related to a discussion of the investment merits of the fund," (ii) the "incidental use of the word 'performance' in connection with a discussion of an investment company . . . without specific mention of . . . a fund's return," (iii) providing a hyperlink to material that is filed with FINRA pursuant to Section 24(b) of the Investment Company Act or Rule 497 under the Securities Act, (iv) providing a hyperlink to "general financial and investment information" and (v) responding to a social media inquiry with "discrete factual information" without discussing a fund's merits, would not be viewed as triggering a filing requirement. However, according to the IM Guidance Update, the staff would view interactive content that discusses or promotes a fund's returns or a fund's investment merits as triggering a filing requirement.

According to the SEC's press release regarding the IM Guidance Update, the Division of Investment Management intends to issue additional IM Guidance Updates in the future addressing legal issues relevant to the investment fund industry.

- ▶ [See a copy of the SEC's press release](#)
- ▶ [See a copy the IM Guidance Update](#)

## Industry Update

### SEC Official Discusses the Role of Fund Directors

Norm Champ, the Director of the SEC's Division of Investment Management (the "**Division**"), discussed, among other things, his views on the role of fund boards of directors during a speech on March 18, 2013 at the 2013 Mutual Funds and Investment Management Conference. According to Champ, the Division will seek to have "insightful in-person meetings" with fund directors, whom Champ sees as the "eyes and ears of fund investors." Champ also noted that regulators such as the SEC rely on fund boards as gatekeepers of the fund industry.

According to Champ, the Division intends to ask fund directors "tough questions" regarding their roles with respect to investment funds. The issues identified by Champ that the Division will raise with fund directors include:

- understanding the areas fund directors believe they add value to the oversight of funds and conversely the areas in which directors believe oversight is more challenging (and relatedly whether fund directors are able to focus on the areas in which they add the most value);
- whether the responsibilities of fund directors are properly allocated;
- whether fund directors are able to ask the "tough questions[ ] and make difficult calls" with respect to the funds they oversee, such as with respect to the appropriateness of fees paid to advisers (including, e.g., fees paid to a sub-adviser responsible for day-to-day management of a fund versus the adviser whose role is to oversee such sub-adviser);
- whether fund directors are focusing on fees paid in connection with securities lending agent arrangements (especially if such agent is an affiliate of the fund the directors oversee);
- whether fund directors are focusing on issues that are specific to a particular fund (as opposed to consideration of issues applicable to a fund complex generally); and
- whether fund directors are overextended (including whether fund directors serve on too many boards).

According to Champ, while there are efficiencies associated with having the same directors serve as board members for multiple funds within a fund family, Champ questioned whether such arrangements can compromise fund directors' oversight functions (and if so, at what point does that happen, Champ queried). According to Champ, in discussing such issues with fund directors, the Division will seek to "maximize the value of fund boards for fund investors."

In addition to his discussion on fund boards, Champ also spoke about (i) the Division's new Risk and Examinations Group, which will "conduct rigorous quantitative and qualitative financial analysis of the investment management industry," (ii) his interest in obtaining input from the public and industry participants on regulatory initiatives and (iii) the Division's need to collect additional data and analysis on mutual funds (noting that such data is now being collected with respect to private funds as a result of Form PF).

- ▶ [See a copy of Champ's speech](#)

### CFTC Provides No-Action Relief for End User Swap Reporting

Pursuant to a series of regulations related to the reporting of swap transactions previously finalized by the CFTC in 2011 and 2012, swap dealers ("**SDs**") and major swap participants ("**MSPs**") were required to begin reporting swap transaction data for interest rate swaps and credit default swaps upon their registration with the CFTC, which for the largest SDs was required by December 31, 2012. Reporting

deadlines for SDs and MSPs phased in for other swap asset classes and for historical swaps through March 30, 2013.

For swaps between end users (that is, between non-SD or MSP counterparties), the reporting deadline for swaps of all asset classes and for historical swaps had been set at April 10, 2013. In response to concerns that swap end users would not be able to comply with this requirement for technological and other reasons, on April 9, 2013, the CFTC's Division of Market Oversight issued no-action relief (the "**April 9th Letter**") to extend this deadline. The April 9th Letter establishes new compliance dates, which differ for "financial entities" (as defined in Section 2(h)(7)(C) of the Commodity Exchange Act) and non-financial entities and depend on the asset class of the swap. These compliance dates are summarized below. Section 2(h)(7)(C) of the Commodity Exchange Act (the "**CEA**") defines "financial entity" to include an SD, an MSP, a security-based swap dealer, a major security-based swap participant, a commodity pool, a private fund, an employee benefit plan or a person predominantly engaged in activities that are in the business of banking or that are financial in nature (as defined in Section 4(k) of the Bank Holding Company Act of 1956, as amended).

### ***Financial entities:***

- Must comply by April 10, 2013 with Part 45 swap data reporting and Part 43 real-time public reporting requirements for interest rate swaps and credit default swaps.
- Must comply by 12:01 a.m. eastern time on May 29, 2013 with Parts 45 and 43 for equity swaps, foreign exchange swaps and other commodity swaps. According to the April 9th Letter, to rely on the no-action relief, a financial entity must, by 12:01 a.m. eastern time on June 29, 2013, backload and report to a swap data repository (an "**SDR**") all swap transaction data for the period from April 10, 2013 to May 29, 2013 that the financial entity would have been required to report in accordance with Part 45 if the CFTC had not issued the April 9th Letter.
- Must comply by September 30, 2013 with the Part 46 historical swap reporting requirement, which covers any swap executed prior to April 10, 2013.

### ***Non-financial entities:***

- Must comply by 12:01 a.m. eastern time on July 1, 2013 with Parts 45 and 43 for interest rate swaps and credit default swaps. According to the April 9th Letter, to rely on the no-action relief, a non-financial entity must, by 12:01 a.m. eastern time on August 1, 2013, backload and report to an SDR all swap transaction data for the period from April 10, 2013 to July 1, 2013 that the non-financial entity would have been required to report in accordance with Part 45 of the CFTC Regulations if the CFTC had not issued the April 9th Letter.
- Must comply by 12:01 a.m. eastern time on August 19, 2013 with Parts 45 and 43 for equity swaps, foreign exchange swaps and other commodity swaps. According to the April 9th Letter, to rely on the no-action relief, a non-financial entity must, by 12:01 a.m. eastern time on September 19, 2013, backload and report to an SDR all swap transaction data for the period from April 10, 2013 to August 19, 2013 that the non-financial entity would have been required to report in accordance with Part 45 of the CFTC Regulations if the CFTC had not issued the April 9th Letter.
- Must comply by October 31, 2013 with Part 46 historical swap reporting requirements, which covers any swap executed prior to April 10, 2013.

According to the April 9th Letter, the extension of the end-user reporting deadlines does not affect the April 10, 2013 deadline by which end users that enter into swaps after such date must obtain a legal entity identifier.

- ▶ [See a copy of the April 9th Letter](#)

## CFTC Extends Temporary Relief for Operators of Certain Securitization Vehicles

On March 29, 2013, the Division of Swap Dealer and Intermediary Oversight (the “**Division**”) of the CFTC issued CFTC Letter No. 13-07, which extends from March 31, 2013 to June 30, 2013 the date by which the operators of certain securitization vehicles must register as a commodity pool operator (a “**CPO**”). In order to claim the relief, the operator of a securitization vehicle must: (1) have filed Forms 7-R and 8-R, as appropriate, and paid any required fees, by March 31, 2013; (2) file a notice with the CFTC requesting relief and (3) comply with Part 4 of the CFTC’s regulations during the relief period, except for certain terms and conditions specified in the March 29th Letter relating to, among other things, performance disclosures, information required in a disclosure document, reporting requirements, recordkeeping requirements and the treatment of fixed income securities in respect of net asset value calculations.

As discussed below, as an alternative to the time limited no-action relief provided by CFTC Letter No. 13-07, the operator of a securitization vehicle would not be required to register as a CPO if it can satisfy the conditions set forth in either CFTC Letter No. 12-14 or CFTC Letter No. 12-45.

**CFTC Letter No. 12-14.** On October 11, 2012, the Division issued CFTC Letter No. 12-14, which stated that certain securitization vehicles would not be included within the definition of “commodity pool” under Section 1a(10) of the CEA and CFTC Regulation 4.10, and that operators of such securitization vehicles would not be included within the definition of “commodity pool operator,” if certain conditions were met, including that the securitization vehicle issuing asset-backed securities (i) comply with either Regulation AB or Rule 3a-7 under the Investment Company Act (as well as compliance by such entity’s assets and its issued securities with either Regulation AB or Rule 3a-7 under the Investment Company Act), (ii) limit its activities to “passively owning or holding a pool of receivables or other financial assets, which may be either fixed or revolving, that by their terms convert to cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to security holders,” (iii) limit derivative use to that which is permitted by Regulation AB, (iv) pay investors only from cash flow generated by its assets but not from or otherwise based upon changes in the value of its assets and (v) not be allowed to trade assets primarily to realize gain or minimize loss as a result of fluctuations in such assets’ market value.

**CFTC Letter No. 12-45.** On December 7, 2012, the Division issued CFTC Letter No. 12-45, which provided further guidance on exclusions from the definition of commodity pool for certain securitization vehicle structures that do not satisfy the requirements of CFTC Letter No. 12-14 because they do not meet all of the technical requirements of either Regulation AB or Rule 3a-7 under the Investment Company Act. In CFTC Letter No. 12-45, the Division also affirmed that “swaps used to provide credit support to financial assets in a securitization or the notes issued by a securitization entity, to the extent contemplated by Item 1114 of Regulation AB, should not be viewed as creating investment exposures” and would not require registration as a CPO. The CFTC noted, however, that if the use of swaps as credit support to financial assets in a securitization is “commercially unreasonable,” the Division may determine that the securitization vehicle is a commodity pool.

In addition, CFTC Letter No. 12-45 provided relief for operators of certain securitization vehicles formed prior to October 12, 2012 if the issuer (i) “issued fixed income securities before October 12, 2012 that are backed by and structured to be paid from payments on or proceeds received in respect of, and whose creditworthiness primarily depends upon, cash or synthetic assets owned by the issuer,” (ii) has not and will not issue new securities on or after October 12, 2012 and (iii) provides the CFTC with certain documentation and information relating to the offering of interests in the pool.

- ▶ [See a copy of CFTC Letter No. 13-07](#)
- ▶ [See a copy of CFTC Letter No. 12-14](#)
- ▶ [See a copy of CFTC Letter No. 12-45](#)

## Litigation

### Hedge Fund Adviser Agrees to Pay Record Amount to Settle Insider Trading Charges

On March 15, 2013, in the largest ever settlement for an insider trading case, the SEC announced that CR Intrinsic Investors, LLC (“**CR Intrinsic**”), an unregistered investment adviser, agreed to pay more than \$600 million to settle charges that it engaged in an insider trading scheme in which it used material non-public information (“**MNPI**”) obtained by CR Intrinsic’s former portfolio manager, Mathew Martoma (“**Martoma**”), to trade shares of two pharmaceutical companies. The announced settlement also included as “relief defendants” S.A.C. Capital Advisors, LLC (“**S.A.C. Capital**”), an affiliated investment adviser of CR Intrinsic, and four hedge funds managed by CR Intrinsic and S.A.C. Capital.

According to the SEC, Elan Corporation (“**Elan**”) and Wyeth LLC (“**Wyeth**”) had jointly developed a drug intended to treat Alzheimer’s disease and, from 2006 to 2008, were in the process of conducting clinical trials on the drug. The SEC alleged that Dr. Sidney Gilman (“**Gilman**”), a medical doctor and a consultant to Elan and Wyeth who served as chairman of a committee (the “**Committee**”) overseeing the clinical trials on the drug, was tasked with presenting the final clinical results of the drug at the International Conference on Alzheimer’s Disease (the “**ICAD**”). As a result, according to the SEC, Gilman possessed MNPI in respect of Elan and Wyeth. The SEC alleged that after being introduced through an expert network firm, as of at least 2007, Gilman provided Martoma with MNPI obtained as a result of Gilman’s role as chairman of the Committee overseeing the clinical trials, including the final trial results. According to the SEC, as of June 30, 2008, CR Intrinsic and S.A.C. Capital portfolios owned more than \$233 million and \$95 million of Elan securities, respectively, and more than \$80 million and \$293 million of Wyeth securities, respectively.

According to the SEC, after learning from Gilman that the results of clinical trial would fail to meet market expectations (but before such information was to be made public at the ICAD), Martoma, the portfolio manager of S.A.C. Capital and S.A.C. Capital’s head trader collaborated to sell (including to sell short) the Elan and Wyeth stock held by the CR Intrinsic and S.A.C. Capital portfolios, which resulted in approximately \$275 million in combined profits and avoided losses for the portfolios managed by the advisers.

Based on this conduct, the SEC charged CR Intrinsic, Martoma and Gilman with violating Section 10(b) of the Securities Exchange Act of 1934 (the “**Exchange Act**”) and Rule 10b-5 thereunder and Section 17(a) of the Securities Act. Without admitting or denying the SEC’s findings, CR Intrinsic agreed to pay \$274,972,541 in disgorgement, \$51,802,381.22 in prejudgment interest and a civil penalty of \$274,972,541. According to the SEC’s press release, the settlement is subject to approval by Judge Victor Marrero of the U.S. District Court for the Southern District of New York. In addition, according to the SEC’s press release, while the settlement does not resolve the charges against Martoma, Gilman has entered into an agreement with the SEC to pay disgorgement and prejudgment interest and to be enjoined from further violations of the anti-fraud provisions of the federal securities laws.

- ▶ [See a copy of the SEC’s press release](#)
- ▶ [See a copy of the SEC’s complaint](#)

### SEC Charges Private Equity Fund Advisers with Misleading Investors about Valuation and Performance

On March 11, 2013, the SEC announced the settlement of charges against two affiliated registered investment advisers – Oppenheimer Asset Management Inc. (“**OAM**”) and Oppenheimer Alternative Investment Management, LLC (“**OAIM**,” and, together with OAM, the “**Advisers**”) – for misleading investors about the valuation policies and performance of Oppenheimer Global Resource Private Equity Fund I L.P. (“**OGR**”), a fund-of-funds managed by the Advisers that was marketed primarily to

sophisticated investors. According to the SEC, from October 2009 to June 2010, the Advisers sent quarterly reports and marketing materials to investors that stated that OGR's assets were valued "based on the underlying managers' estimated values." According to the SEC, the quarterly reports and marketing materials were misleading because OGR's portfolio manager instead valued OGR's largest investment using a different valuation method. According to the SEC, the change in the valuation method as it related to OGR's largest investment caused OGR's internal rate of return to increase from approximately 3.8% to 38.3% for the quarter ended June 30, 2009.

Further, the SEC alleged that OAIM's employees misrepresented to potential investors that (i) the increase in the value of OGR's largest investment was a result of the underlying fund's performance (as opposed to the result of the different valuation method used by the Advisers' portfolio manager), (ii) the value of the largest investment came from a third party valuation firm retained by the underlying fund manager and (iii) the funds in OGR's investment portfolio were audited (when, in fact, the fund that was the largest investment was not audited).

In addition, the SEC alleged that the Advisers' written policies and procedures "were not reasonably designed to ensure that valuations provided to prospective and existing investors were presented in a manner consistent with written representations to investors and prospective investors."

Based on this conduct, the SEC charged the Advisers with violating Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(4) of the Investment Advisers Act of 1940, as amended (the "**Advisers Act**"), and Rules 206(4)-7 and 206(4)-8 promulgated thereunder. Without admitting or denying the SEC's findings, the Advisers agreed to settle the charges. The SEC censured the Advisers, ordered them to cease and desist from future violations of the relevant provisions of the Securities Act and the Advisers Act and ordered them to pay a civil penalty of \$617,579. In addition, the Advisers agreed (1) to disgorge \$2,128,232 and pay prejudgment interest, (2) to provide a copy of the SEC's order to its existing advisory clients and to prospective advisory clients for a one-year period and (3) to retain an independent compliance consultant to conduct a comprehensive compliance review of the Advisers' valuation policies and procedures and to adopt all of the consultant's recommendations (or propose an alternative policy if any recommendation is considered unduly burdensome).

According to the SEC's press release, the Advisers also agreed to pay an additional penalty of \$132,421 in a related state-law action.

- ▶ [See a copy of the SEC's press release](#)
- ▶ [See a copy of the SEC order](#)

### **SEC Settles Charges Against Investment Adviser, Former Executive and Consultant for Operations as an Unregistered Broker**

On March 8, 2013, the SEC announced the settlement of charges stemming from a private fund adviser's alleged retention of a solicitor that was not properly registered as a broker. The SEC action involved a holding company that controls affiliated investment advisers that manage private funds (the "**Adviser**"), the Adviser's former Senior Managing Partner (the "**former executive**"), who was in charge of capital raising efforts for the private funds managed by the Adviser, and an independent consultant retained by the Adviser, who was not a registered broker or affiliated with one and who the SEC alleged improperly solicited more than \$500 million in capital commitments for the private funds managed by the Adviser. According to the SEC, from 2008 to 2011, the independent consultant actively solicited investors for the private funds managed by the Adviser and was paid a percentage of the capital committed by investors sourced by the independent consultant. The SEC alleged that the independent consultant solicited potential investors by (1) sending to potential investors private placement memoranda, subscription documents and due diligence materials that were provided to the consultant by the former executive or other personnel of the Adviser, (2) encouraging potential investors to make portfolio reallocations to enable such investors to invest in the private funds managed by the Adviser, (3) providing his analysis of

the Adviser's strategy and track record and (4) providing potential investors with confidential information related to the private funds (including current and potential investors' identities and their capital commitments).

According to the SEC, the former executive ignored red flags that indicated that the independent consultant's solicitation efforts went beyond the consultant's intended role as a supposed "finder." In addition, the SEC alleged that the Adviser "failed to adequately oversee [the independent consultant's] activities" by giving the consultant access to fund documents and reimbursing the consultant for expenses associated with his efforts (such as travel and entertainment expenses) that should have indicated to the Adviser that the consultant had substantial (and improper) contact with potential investors.

Based on such conduct, the SEC found that the independent consultant willfully violated Section 15(a) of the Exchange Act, which "requires persons engaged in the business of effecting transactions in securities to be registered as a broker or dealer or associated with a registered broker or dealer." The SEC also found that the former executive willfully aided and abetted the independent consultant's violations and that each of the former executive and the Adviser caused the independent consultant's violations.

Without admitting or denying the SEC's findings, the Adviser and the former executive agreed to pay civil penalties of \$375,000 and \$75,000, respectively, and to cease and desist from further violation of Section 15(a) of the Exchange Act. In addition, according to the SEC, the former executive was suspended from acting in a supervisory capacity of an investment adviser or other securities market participant for nine months and the independent consultant was barred from the securities industry. According to the SEC, in accepting the Adviser's settlement offer, the SEC considered that, subsequent to the alleged conduct, the Adviser changed its policies and procedures so that third parties retained by the Adviser as a finder or marketer are required to be a registered broker (or affiliated with a registered broker).

- ▶ [See a copy of the SEC's press release](#)
- ▶ [See a copy of the SEC's order against the Adviser and the former executive](#)
- ▶ [See a copy of the SEC's order against the independent consultant](#)

## SEC Brings Insider Trading Charges Against Portfolio Manager and Settles Charges with Investment Adviser

On March 29, 2013, the SEC charged Michael S. Steinberg ("**Steinberg**"), a portfolio manager at Sigma Capital Management, LLC ("**Sigma Capital**"), an unregistered investment adviser, with trading on material non-public information ("**MNPI**") in respect of Dell, Inc. ("**Dell**") and Nvidia Corporation ("**Nvidia**"). In addition, on March 15, 2013, the SEC announced that Sigma Capital had agreed to settle charges that it, a private fund it managed, and a private fund managed by an affiliate of Sigma Capital, engaged in, and were unjustly enriched by, trading on MNPI. According to the SEC's press releases, the charges are part of an ongoing investigation into expert networks and the trading activities of hedge funds.

The SEC alleged that, in 2008 and 2009, Jon Horvath ("**Horvath**"), a former analyst for Sigma Capital, obtained MNPI regarding Dell's quarterly earnings information and other performance data through communication with a group of hedge fund analysts that regularly shared MNPI. The SEC further alleged that in 2009 and 2010, Horvath obtained MNPI concerning Nvidia's calculation of its revenues, gross profit margins and other financial information from the analyst group. According to the SEC, Horvath provided the MNPI regarding Dell and Nvidia to Steinberg and another portfolio manager of Sigma Capital, who executed illegal trades (and caused an adviser that was affiliated with Sigma Capital to execute illegal trades with respect to a private fund managed by such affiliated adviser) in advance of at least four quarterly earnings announcements of the companies, which resulted in more than \$6 million in profits and avoided losses for the funds managed by Sigma Capital and its affiliated adviser.

The SEC charged Steinberg and Sigma Capital with violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. In settling, without admitting

or denying the charges, Sigma Capital agreed to pay \$6,425,000 in disgorgement, \$1,094,161.92 in prejudgment interest and a civil penalty of \$6,425,000, according to the SEC. According to the SEC's press release, the SEC is seeking remedies against Steinberg that include disgorgement, prejudgment interest, financial penalties and permanent enjoinder from future violations of the relevant provisions of the federal securities laws. Further, according to the SEC, the U.S. Attorney's Office for the Southern District of New York is pursuing criminal charges against Steinberg.

- ▶ [See a copy of the SEC's press release announcing the charges against Steinberg](#)
- ▶ [See a copy of the SEC's press release announcing the charges against Sigma Capital](#)
- ▶ [See a copy of the SEC's complaint against Steinberg](#)
- ▶ [See a copy of the SEC's complaint against Sigma Capital](#)

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