

Investment Management & Funds Regulatory Update - May 2024

May 31, 2024 | Client Update | 4-minute read

In this issue, we discuss proposed customer identification requirements for investment advisers and amendments regarding expanded cybersecurity requirements for broker-dealers, investment advisers and investment companies. We also discuss a recent enforcement action involving an investment adviser and failure to disclose conflicts of interest.

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Rules and regulations

FinCEN and SEC propose Customer Identification Program requirements for investment advisers

The Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Department and the Securities and Exchange Commission (SEC) recently issued a proposed rulemaking that would require investment advisers registered with the SEC (RIAs) and investment advisers that report to the SEC as exempt reporting advisers (ERAs) to establish, document and maintain written customer identification programs (CIPs) (the Proposed CIP Rule) as part of their anti-money laundering and countering the financing of terrorism (AML/CFT) compliance programs. For more information on the Proposed CIP Rule, please see our recent [client update](#) on this topic.

SEC expands cybersecurity requirements of Regulation S-P, the “Safeguards Rule”

The SEC expanded the scope of the Safeguards Rule, which already required broker-dealers, investment advisers and investment companies to have reasonably designed policies and procedures to protect customer information. The SEC amended the rule to add requirements for incident response programs, customer notifications, and regulatory obligations. For more information on the amended Safeguards Rule, please see our recent [client update](#) on this topic

Litigation

SEC charges investment adviser and founder for failing to disclose conflicts of interest

On May 14, 2024, the SEC issued an [order](#) (the Order) instituting and settling administrative and cease-and-desist proceedings against Hudson Valley Wealth Management, Inc., a registered investment adviser, and its principal, Christopher Conover. Hudson Valley Wealth Management advised separately managed accounts (SMAs) for its clients and a private investment fund (Fund) that invested in films by making loans to film production companies. According to the Order, Hudson Valley Wealth Management breached its fiduciary duty to its clients and Fund investors by failing to disclose a conflict of interest related to payments received by Conover from a third-party film production company, misleading its clients and Fund investors regarding the nature of such payments, and giving preferential treatment to one Fund investor’s redemption request over other investors’ requests.

In 2017, Conover allegedly negotiated an agreement with a film studio and production company under which Hudson Valley Wealth Management would invest its clients’ and the Fund’s assets exclusively in film projects produced by such studio and production company. Thereafter, all film loans made by the SMAs and the Fund were to projects of such studio and production company. Conover also allegedly negotiated the right to receive a share of the executive producer compensation for certain films in which the Fund or other clients invested, and typically received 3% of the total amount of loans the Fund or other clients made with respect to such films. Conover allegedly received a total of \$531,787 in executive producer compensation and did not distribute any of such compensation to the SMAs, the Fund or its investors.

According to the Order, the Fund’s offering documents and Hudson Valley Wealth Management’s Form ADV did not disclose the compensation arrangement and related conflicts until May 2019; thereafter, according to the Order, the disclosures made were materially misleading because they failed to disclose that the executive producer compensation received by Conover was based solely on amounts loaned by the Fund and SMAs (not for production work), and falsely stated that such compensation was not based on client investments.

By early 2021, the production company began to default on the loans made by the Fund and SMAs, and according to the Order, the Fund lacked sufficient liquidity to fulfill redemption requests. However, in May 2021, at Conover’s direction, the Fund allegedly fulfilled an investor’s request to redeem \$187,789 in full ahead of approximately \$750,000 in redemption requests from other investors that were left unfulfilled.

On account of this alleged conduct, the SEC charged Hudson Valley Wealth Management and Conover with violations of Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder. Hudson Valley Wealth Management and Conover agreed to be censured and cease and desist from future violations. Hudson Valley Wealth Management also agreed to pay a civil money penalty of \$200,000, and Conover agreed to pay disgorgement of \$531,787, prejudgment interest of \$95,924.09, and a civil penalty of \$150,000.

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