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SIXTH ANNUAL

Advanced Topics in Hedge Fund Practices Conference:

MANAGER AND INVESTOR PERSPECTIVES

Thursday, May 2, 2013 | The Metropolitan Club, New York City

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SIXTH ANNUAL
ADVANCED TOPICS IN HEDGE FUND PRACTICES CONFERENCE:
Manager and Investor Perspectives

May 2, 2013

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SIXTH ANNUAL ADVANCED TOPICS IN HEDGE FUND PRACTICES CONFERENCE:
Manager and Investor Perspectives

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Agenda

8:00 – 8:30 a.m.	Registration and Breakfast	
8:30 – 8:40 a.m.	Introduction	Jedd Wider and Robert Mendelson
8:40 – 9:15 a.m.	Enforcement Trends and Issues	Anne Flannery and Ivan Harris
9:15 – 9:50 a.m.	Regulatory and Inspection Priorities for Private Fund Advisers	Timothy Levin and Jennifer Klass
9:50– 10:25 a.m.	Current Hedge Fund Environment: Institutional Investor and Manager Perspectives	Jedd Wider, Louis Singer, and Christopher Dlutowski
10:25 – 10:40 a.m.	**Break**	
10:40 – 10:55 a.m.	Investor Relations and Finder Activity: When is it Brokerage? (Micro Session)	Robert Mendelson
10:55 – 11:40 a.m.	Swaps Regulation is Here	Michael Philipp, Michael Piracci, Thomas D'Ambrosio and Will Iwaschuk
11:40 – 11:55 a.m.	Lessons of Litvak: The Trade Negotiation Process (Micro Session)	Robert Mendelson and Ivan Harris
11:55 – 12:10 p.m.	**Break**	
12:10 – 12:45 p.m.	JOBS Act, AIFMD and Current Tax Issues	William Yonge, Ethan Johnson and Richard Zarin
12:45 – 2:00 p.m.	**Lunch and Keynote Presentation**	Robert Feinstein Chief Legal Officer, South Carolina Retirement System Investment Commission Joseph D. Glatt General Counsel, Apollo Capital Management, L.P. Secretary and Vice President, Apollo Investment Corporation
2:00 – 2:30 p.m.	Trading and Investment Practices Developments Affecting Hedge Funds	Mark Fitterman, David Sirignano and Will Iwaschuk
2:30 – 3:30 p.m.	FCPA – Ethical Issues for Hedge Fund Lawyers and Compliance Professionals	Martha Stolley

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SEC Enforcement Developments

Ivan P. Harris

Anne C. Flannery

Please note that any advice contained in this communication is not intended or written to be used, and should not be used, as legal advice.

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Part I: SEC Enforcement Climate and Trends

Current Climate and Trends

- Asset Management Unit and the Market Abuse Unit Remain Active, Using More Sophisticated Approaches
  - Aberrational Performance Initiative
  - Automated Bluesheet Analysis Project
- Office of Market Intelligence (new director, Vince Martinez)
- 3,001 Tips Made to SEC Whistleblower Office in First Full Year of Operation
- Potential New Cop on the Beat: Financial Crimes Enforcement Network (FinCEN), which is reportedly working on a rule to require hedge funds to file suspicious activity reports (SARs)

Current Climate and Trends (continued)

- Many Enforcement Cases (734 in Fiscal Year 2012)
  - 58 insider trading cases, many with parallel prosecutions
  - 147 investment advisor cases
- Changes in SEC Leadership
  - Mary Schapiro → Elisse Walter → Mary Jo White
  - Rob Khuzami → George Canellos/Andrew Ceresney
  - Bruce Karpati reportedly leaving as Head of Division of Enforcement's Asset Management Unit

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Part II: Private Funds

The Current Regulatory Climate for Private Funds

- Enforcement Areas Explained in More Detail Below:
  - Insider Trading and Expert Networks
  - Focus on Statements to Investors and on Valuation
  - Conflicts/Related Party Transactions
  - Compliance Issues

Can Materiality Be Security-Specific?

- FSA says "Yes"

  "Although dividend timing may not be inside information relating to the underlying equity, . . . it may in some cases be inside information in relation to single stock and equity index futures and options (where those derivative instruments are related investments) for the purposes of market abuse provisions in the Financial Services and Markets Act 2000 ('FSMA')." (*FSA Market Watch* October 2012)
- European Securities and Markets Authority Agrees, See SMA/2012/9, January 2012
- No insider trading law on this point in the U.S., but the SEC defined a notice of redemption of trust preferred securities, sent only to the trustee and to DTC, as MNPI in a Regulation FD case. See In the Matter of Fifth Third Bancorp, Exchange Act Rel. No. 65808 (Nov. 22, 2011).

Two Important Second Circuit Decisions Involving Insider Trading and Hedge Funds

- *SEC v. Obus*, 695 F.3d 276, 289 (2d Cir. 2012), regarding tipping liability:
  - Tipper is liable if he
    (1) Had a duty to keep MNPI confidential;
    (2) Breached that duty by intentionally or recklessly relaying the information to a tippee who could use the information in trading;
    (3) Received a personal benefit (which could be "reputational," or the ability to give a gift, *id*. at 285) from the tip.
  - Tippee is liable if
    (4) Tipper breached a duty by tipping MNPI;
    (5) Tippee knew or had reason to know that the information was obtained through the tipper's breach;
    (6) Tippee, while having possession of the MNPI, used the information by trading or tipping for his own benefit.

Two Important Second Circuit Decisions Involving Hedge Funds

- *U.S. v. Contorinis*, 692 F.3d 136 (2d Cir. 2012) regarding materiality of a tip where some information is already circulating in the public domain.
  - Insider tip may be material if it includes additional details, such as the expected amount of earnings decline even if it was generally expected that earnings would decline by some amount.
  - Insider tip may be material if it provides additional reliability to existing information.

The Role of Expert Networks – Providing Tiles for the Mosaic

- Stated role is to provide primary research data in a manner that does not convey MNPI illegally
- Many such firms provide training to their experts and have compliance programs
  - Terms and conditions for consultants
  - Do not call list and/or no public company employees
- Targets of Enforcement
  - E.g., *SEC v. CR Intrinsic Investors, LLC*, Lit. Rel. No. 22539 (Nov. 20, 2012) (expert network provides MNPI about clinical trial of Alzheimer's drug). CR recently agreed to pay more than $600 million to settle charges

The Role of Expert Networks – Providing Tiles for the Mosaic (continued)

- “Political Intelligence” Firms
  - New class of actors
  - New legislation: The STOCK Act
  - New investigations

Market Manipulation

- Intentional conduct designed to deceive investors by controlling or artificially affecting the market, which includes:
  - Spreading false or misleading information about a company;
  - Improperly limiting the number of publicly available shares;
  - Front running;
  - Running a “short squeeze”
    - *SEC v. Harbinger Capital Partners, LLC,* Lit. Rel. No. 22403 (June 28, 2012)

Market Manipulation (continued)

– Rigging quotes, prices, or trades to create a false sense of demand.

- *SEC v. Tiger Asia Management, LLC,* SEC Press Rel. No. 2012-264 (Dec. 12, 2012) ($44 million settlement of charges that included shorting around private placements of Chinese bank stocks and entering losing trades to increase value of short positions in portfolios).
- *SEC v. RKC Capital Management, LLC,* Lit. Rel. No. 22353 (May 1, 2012) (allegedly "marking the close" in portfolio securities to attract investments and to boost advisory fees)

Conflicts of Interest Cases

- Related Party Transactions/Valuation
  - *SEC v. Commonwealth Advisors, Inc. and Walter A. Morales*, Press Rel. No. 2012-222 (Nov. 8, 2012). Adviser executed cross transactions between funds in order to conceal $32 million in losses from a CDO investment made during the financial crisis.
- Side-by-side management
  - *In the Matter of Martin Currie, et al.* AP File No. 3-14873 (May 10, 2012). Fund management group caused its public fund client to invest in a company whose bonds were owned by its private fund client, which needed liquidity. The investment enabled the company to redeem the bonds and the private fund to satisfy redemptions.
  - *In the Matter of Harborlight Capital Management, LLC* AP File No. 3-15295 (April 22, 2013). Manager caused fund of funds to invest in an affiliated fund to satisfy redemption requests pending in the affiliated fund.

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Conflicts of Interest Cases

- Redemptions/Fund Restructurings
  - *SEC v. Philip A. Falcone, et al.*, Civil Action Nos. 12 Civ. 5027 & 5028 (Crotty) (S.D.N.Y., filed July 27, 2012).
    - Adviser secretly offered and granted favorable redemption and liquidity rights to certain "strategically-important investors" in exchange for those investors' consent to restrict redemption rights of other fund investors, and concealed the arrangement from the fund's directors and investors
  - *SEC v. New Stream Capital, LLC, et al.*, Lit. Rel. No. 22625 (Feb. 26, 2013) (misrepresentations to investors about restructuring of fund to placate largest investor, and about level of redemptions).
    - Fund originally restructured to eliminate preferential redemption rights, including those previously granted to largest investor.
    - To placate largest investor, fund manager gave it priority over other investors in the event of a liquidation.
    - Fund continued to market itself as giving all investors equal footing.

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Focus on Statements to Investors and on Valuation

- *In the Matter of Top Fund Management, Inc.*, Securities Act Rel. No. 9377 (Dec. 21, 2012) (undisclosed use of options to make up 75% of fund's portfolio, contrary to stated investment policy)
- *In the Matter of Yorkville Advisors, LLC*, Lit. Rel. No. 22510 (Oct. 17, 2012) (failure to follow Fund's valuation procedures for illiquid investments, which required getting third-party valuations)
- *In the Matter of KCAP Financial, Inc.,* Exch. Act. Rel. No. 68307 (Nov. 28, 2012) (in first ever FAS 157 case, fund manager charged with valuing CLO investments at cost instead of exit value; distressed market no excuse)

Focus on Statements to Investors and on Valuation (continued)

- *In the Matter of Umesh Tandon*, Advisers Act Rel. No. 3586 (Apr. 18, 2013) (misrepresentations to CalPERS and other current and potential clients about AUM)
- *SEC v. Aletheia Research and Management, Inc*., Lit. Rel. No. 22573 (Dec. 14, 2012) (failing to disclose adviser's troubled financial condition to clients until immediately before advisor's bankruptcy filing; complaint also alleges "cherry-picking" of winning trades to managers' personal accounts and to certain favored clients, to detriment of hedge fund investors)

Focus on Statements to Investors and on Valuation (continued)

- "Skin in the game" cases
  - *In the Matter of Quantek Asset Management, LLC, et al.* AP File No. 3-14893 (May 29, 2012) (multiple misrepresentations regarding fund managers' "skin in the game"; improperly documented and secured related party loans made to affiliates of fund executive and former parent company)
  - *In the Matter of Aladdin Capital Management LLC and Aladdin Capital LLC* (Sec. Act. Rel. No. 9374) (Dec. 17, 2012) (misrepresentations regarding co-investment in CDOs and CLOs alongside investors)

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Compliance Issues

- *In the Matter of Consultiva Internacional, Inc.*, Advisers Act Rel. No. 3441 (Aug. 3, 2012) (failure to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and rules)
- *In the Matter of EM Capital Management*, Advisers Act Rel. No. 3502 (Nov. 20, 2012) (failure to respond to SEC exam requests)

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Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

Regulatory and Inspection Priorities for Private Fund Advisers

Jennifer L. Klass
Timothy W. Levin

May 2, 2013

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Recent Trends in Examination Process

- Enhanced cooperation between OCIE, Enforcement and Division of Investment Management
  - Enforcement appears earlier, often during routine examinations
  - Proactive approach to identifying questionable practices
- Increased knowledge and quantitative analytics
  - Industry specialists
  - Risk analytic initiatives
- Focus on private fund advisers

Examination Priorities

- National Exam Program – Wide Initiatives
  - Fraud Detection and Prevention
  - Corporate Governance and Enterprise Risk Management
    - *Approach to enterprise risk management*
    - *Tone at the top*
    - *Dialog on key risks and regulatory requirements*
  - Conflicts of Interest
    - *Overall risk governance framework to manage conflicts*
    - *Identification of specific conflicts, mitigation and disclosure*
  - Technology

Examination Priorities (continued)

- Investment Adviser – Investment Company Program
  - Safety of Assets
    - *Significant Deficiencies Involving Adviser Custody and Safety of Client Assets*
  - Compensation Arrangements
  - Marketing and Performance
  - Allocation of Investment Opportunities
  - New Registrants
    - *“Presence Exams” for Newly Registered Investment Advisers*
  - Compliance with Pay to Play Rule

Policy Initiatives

- Broker-Dealer Status
  - Fund adviser that pays its personnel transaction-based compensation for selling fund interests or that has personnel whose primary function is to sell fund interests
  - Receipt of transaction-based compensation by adviser, its personnel or affiliates for investment banking or other broker activities relating to portfolio companies
- Review of Advisers Act Rules that Apply to Private Fund Advisers

NATIONAL EXAM PROGRAM
RISK ALERT

By the Office of Compliance Inspections and Examinations[1]

Volume III, Issue 1 **March 4, 2013**

In this Alert:

Topic: *NEP staff observations regarding ways in which advisers fail to comply with the Advisers Act custody rule.*

Key Takeaways: *Advisers should review their practices in light of the deficiencies noted in this Risk Alert and their responsibilities under the custody rule to protect client assets.*

Significant Deficiencies Involving Adviser Custody and Safety of Client Assets

One of the most critical rules under the Investment Advisers Act of 1940 ("Advisers Act") is the custody rule,[2] which is designed to protect advisory clients from the misuse or misappropriation of their funds and securities. Yet, the SEC's National Examination Program ("NEP") has observed widespread and varied non-compliance with elements of the custody rule.[3] The NEP reviewed recent examinations that contained significant deficiencies. Approximately one-third of them (over 140) included custody-related issues.

In this Risk Alert, the NEP staff shares the custody deficiencies observed, which we hope will assist investment advisers in complying with the custody rule. When the NEP staff identifies the risk priority areas to focus on during an examination of an adviser, it often includes a review of the adviser's books and records, business, and operations as they relate to the safety of its clients' assets. The findings from these examinations have resulted in a range of actions. These have included remedial measures taken by advisers, including among other things, drafting, amending or enhancing their written compliance procedures, policies, or processes; changing their business practices; or devoting more resources or attention to the area of custody. Moreover, the NEP has also made referrals to the SEC's Division of Enforcement where appropriate.

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1 The Securities and Exchange Commission ("SEC"), as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed here are those of the staff of the Office of Compliance Inspections and Examinations, in coordination with other SEC staff, including staff in the Division of Enforcement's Asset Management Unit and the Division of Investment Management, and do not necessarily reflect the views of the Commission or the other staff members of the SEC. This document was prepared by the SEC staff and is not legal advice.

2 Rule 206(4)-2 under the Advisers Act, 17 CFR 275.206(4)-2, as amended.

3 The rule was first adopted in 1962. *See* Adoption of Rule 206(4)-2 under the Investment Advisers Act of 1940, Investment Advisers Act Release No. 123 (Feb. 27, 1962), 27 FR 2149 (Mar. 6, 1962). Major amendments were made in 2003 and 2009. *See* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Rel. 2176 (Sept. 25, 2003), 68 FR 56692 (Oct. 1, 2003); Custody of Funds or Securities by Investment Advisers, Investment Advisers Act Rel. 2968 (Dec. 30, 2009), 75 FR 1456 (Jan. 11, 2010). The staff of the SEC's Division of Investment Management has published responses to frequently asked questions about the custody rule, *available at* http://www.sec.gov/divisions/investment/custody_faq_030510.htm.

Background of the Custody Rule

SEC-registered investment advisers with custody of client assets must comply with the custody rule. An adviser has custody if it or its related person holds, directly or indirectly, client funds or securities or has any authority to obtain possession of them.[4] For example, an adviser that serves as the general partner of a pooled investment vehicle ("PIV")(or holds a comparable position) generally has custody of client assets because the position of general partner gives legal ownership or access to client funds and securities.[5] The custody rule prescribes a number of requirements designed to enhance the safety of client assets by insulating them from any possible unlawful activities or financial reverses of the investment adviser, including insolvency.[6] The custody rule's key safeguards include:

- *Use of "qualified custodians" to hold client assets*. An adviser with custody generally must maintain client funds and securities at a qualified custodian (*e.g.*, a bank or a broker-dealer), either in a separate account for the client under the client's name or in an account under the adviser's name as agent or trustee for the adviser's clients that contains only client assets (*i.e.*, client assets may not be commingled with the adviser's assets). [7]

- *Notices to clients detailing how their assets are being held*. An adviser that opens an account with a qualified custodian on the client's behalf must notify the client in writing and provide the client with certain information.[8]

- *Account statements for clients detailing their holdings*. An adviser must have a reasonable basis, after due inquiry, for believing that the qualified custodian sends account statements to clients at least quarterly.[9]

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4 Rule 206(4)-2(d)(2).

5 Rule 206(4)-2(d)(2)(iii).

6 *See* Adoption of Rule 206(4)-2 under the Investment Advisers Act of 1940, Investment Advisers Act Rel. 123 (Feb. 27, 1962), 27 FR 2149 (Mar. 6, 1962).

7 Rule 206(4)-2(a)(1).

8 Rule 206(4)-2(a)(2). The client must be provided with the name and address of the qualified custodian and the manner in which the client funds or securities are being held. The adviser must promptly inform the client when the account is opened and following any change in this information.

9 Rule 206(4)-2(a)(3). *See* In re Gerasimowicz, Advisers Act Rel. 3464 (instituted Sept. 14, 2012)(administrative and cease-and-desist proceedings instituted against a registered adviser and its principal in connection with allegations of misappropriation of assets and repeatedly making material misrepresentations and omissions to clients). Among the charges in this case, in addition to fraud, were allegations that (1) the advisers and principal, not the custodian, sent quarterly statements to fund investors; (2) the adviser did not obtain an annual surprise examination; and (3) the principal and the adviser did not distribute annual audited financial statements, prepared in accordance with GAAP and audited by an independent public accountant that is registered with and subject to regular inspection by the Public Company Accounting Oversight Board ("PCAOB"), within 120 days of the end of fiscal year (thus failing to satisfy the "audit approach" exception to the custody rule on which the adviser was purporting to rely).

- *Annual surprise exams*. Advisers that have custody of client assets in many cases must undergo an annual surprise examination by an independent public accountant that verifies client funds and securities.[10]

- *Additional protections when a related qualified custodian is used*. If the adviser's related person (or the adviser itself) acts as the qualified custodian, then the annual surprise examination must be conducted by an independent accountant registered with, and subject to regular inspection by, the PCAOB, and the adviser must obtain from the accountant at least once each year a report of the internal controls relating to the custody of client assets.[11]

- *The audit approach for advisers to pooled investment vehicles*. With the "audit approach," the adviser, at least annually, distributes audited financial statements to investors in the pooled investment vehicles. If using the "audit approach," advisers to pooled investment vehicles do not have to comply with the notice and account statement delivery obligations of Rule 206(4)-2(a)(2) and (a)(3) and are deemed to have satisfied the surprise examination requirement of Rule 206(4)-2(a)(4).[12]

Deficiencies Identified

The custody-related deficiencies NEP staff observed can be grouped into four categories: failure by an adviser to recognize that it has "custody" as defined under the custody rule;[13] failures to comply with the rule's "surprise exam" requirement;[14] failures to comply with the "qualified custodian" requirements;[15] and failures to comply with the audit approach for pooled investment vehicles.[16]

- **Failure By Advisers To Recognize They Have Custody**

In its review, NEP staff observed the following situations where an adviser failed to recognize that it has custody under the rule:

10 Rule 206(4)-2(a)(4). *See also* paragraphs (b)(3),(b)(4), and (b)(6) of Rule 206(4)-2. The independent accountant must file Form ADV-E in accordance with Rule 206(4)-2(a)(4) following a surprise examination. *See also* In re Gerasimowicz, *supra* note 10 (alleging adviser did not obtain an annual surprise examination under the custody rule and failed to meet the "audit approach" exception to the surprise examination requirement).

11 Rule 206(4)-2(a)(6).

12 Rule 206(4)-2(b)(4).

13 Rule 206(4)-2(d)(2). As noted above, an adviser has custody if it or its related person holds, directly or indirectly, client funds or securities or has any authority to obtain possession of them. As one example, an adviser who serves as the general partner (or holds a comparable position) to a pooled investment vehicle has custody of client funds/securities.

14 Rule 206(4)-2(a)(4). *See* "Annual surprise exams" above.

15 The term "qualified custodian" is defined in Rule 206(4)-2(d)(6) to mean certain banks and savings associations, broker-dealers registered with the SEC, futures commission merchants registered with the Commodity Futures Trading Commission, and foreign financial institutions that meet certain criteria. *See* "Use of 'qualified custodians' to hold client assets" above.

16 *See* "The audit approach for advisers to pooled investment vehicles" above.

- **The Role of Employees or Related Persons**[17]: The adviser's personnel or a "related person" serve as trustee or have been granted power of attorney for client accounts.[18]

- **Bill-Paying Services:** The adviser provides bill-paying services for clients and, therefore, is authorized to withdraw funds or securities from the client's account.[19]

- **Online Access to Client Accounts:** The adviser manages portfolios by directly accessing online accounts using clients' personal usernames and passwords without restrictions and, therefore, has the ability to withdraw funds and securities from the clients' accounts.[20]

- **Adviser Acts as a General Partner**: The adviser serves as the general partner of a limited partnership or holds a comparable position for a different type of pooled investment vehicle.[21]

- **Physical Possession of Assets**: The adviser has physical possession of client assets, such as securities certificates.[22]

- **Check-Writing Authority**: The adviser or a related person has signatory and check writing authority for client accounts.[23]

- **Receipt of Checks Made to Clients**: The adviser received checks made out to clients and failed to return them promptly to the sender.[24]

➢ **Surprise Exam Requirement**

NEP staff observed deficiencies regarding surprise exams when:

- A Form ADV-E was not filed within 120 days after the date of the exam chosen by the accountant.[25]

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17 A "related person" is defined in Rule 206(4)-2(d)(7) to mean "any person, directly or indirectly, controlling or controlled by the adviser, and any person that is under common control with the adviser."

18 Rule 206(4)-2(d)(2)(ii).

19 Rule 206(4)-2(d)(2). *See* Custody of Funds or Securities of Clients by Investment Advisers, Section II. A., Investment Advisers Act Rel. 2176 (Sept. 25, 2003), 68 FR 56692 (Oct. 1, 2003).

20 Rule 206(4)-2(d)(2).

21 Rule 206(4)-2(d)(2)(iii).

22 Rule 206(4)-2(d)(2)(i).

23 Rule 206(4)-2(d)(2).

24 Rule 206(4)-2(d)(2)(i).

25 Rule 206(4)-2(a)(4)(i).

- Evidence suggested that examinations were not being conducted on a "surprise" basis (*e.g.*, exams were conducted at the same time each year).[26]

➢ **Qualified Custodian Requirements**

Certain advisers did not satisfy the "qualified custodian" requirements when:

- Client assets were held in the adviser's name, but not in an account that was under the adviser's name as agent or trustee for the client and that held only client assets.[27]
- The adviser commingled client, proprietary, and employee assets into one account.[28]
- Certificates of securities[29] held by the adviser's fund were held in a safe deposit box controlled by the adviser at a local bank.[30]
- The adviser did not have a reasonable basis, after due inquiry, for believing that a qualified custodian was sending quarterly account statements to the client.[31]
- In instances where the adviser opened a custodial account on behalf of a client and sent account statements to the client, the statements sent by the adviser failed to include

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26 Rule 206(4)-2(a)(4).

27 Rule 206(4)-2(a)(1) requires the qualified custodian to maintain client assets in a separate account for each client under the client's name or in accounts under the name of the adviser as agent or trustee for the clients (which is permitted only if the accounts contain only clients' funds and securities). *See SEC v. Commonwealth Advisors, Inc.*, (M.D. La.)(filed Nov. 8, 2012) (adviser alleged, among other things, to have engaged in a scheme to hide losses from certain hedge funds it managed and to have violated the qualified custodian requirements of the custody rule because it held fund assets in an account in its name, rather than in an account in the client's name or in the adviser's name as agent or trustee for the client).

28 Rule 206(4)-2(a)(1).

29 Although Rule 206(4)-2(b)(2) excepts certain privately offered securities from the requirement that client securities be held by a qualified custodian, this exception is subject to several conditions, including that the privately issued securities must be uncertificated and their ownership must be recorded only on the books of the issuer or its transfer agent. In addition, the securities must have been acquired from the issuer in a transaction or chain of transactions not involving any public offering and must be transferable only with the prior consent of the issuer or holders of the issuer's outstanding securities.

30 As the SEC has explained, because client funds and securities must be held on behalf of the client by the qualified custodian so that the qualified custodian can provide account information to the clients, keeping stock certificates in the adviser's bank safe deposit box, for example, would not satisfy the requirements of the rule. *See* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Rel. 2176 (Sept. 25, 2003), 68 FR 56692 (Oct. 1, 2003) at note 18.

31 Rule 206(4)-2(a)(3).

notification urging clients to compare the account statements from the custodian with those from the adviser.[32]

- **Audit Approach Issues**

Some advisers that relied on the "audit approach" with respect to pooled investment vehicles were not in compliance because:

- The accountant that conducted the financial statement audit was not "independent" under Regulation S-X, as required by the custody rule.
- The audited financial statements were not prepared in accordance with GAAP (*e.g.*, organizational expenses were improperly amortized rather than expensed as incurred, resulting in a qualified audit opinion; financial statements were prepared on a federal income tax basis; the adviser could not substantiate fair valuations and the accountant therefore could not issue an unqualified opinion on the financial statements).[33]
- The adviser failed to demonstrate that the audited financial statements were distributed to *all* fund investors. Rather, it appeared that in many instances the statements were only made available "upon request."[34]
- The audited financial statements were not sent to investors within 120 days of the private funds' fiscal year ends (or 180 days for fund of funds).[35]
- The auditor was not PCAOB-registered and subject to PCAOB inspection.[36]
- A final audit was not performed on liquidated pooled investment vehicles.[37]

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32 Rule 206(4)-2(a)(2). The custody rule does not require an adviser that opens a custodial account on the client's behalf to send account statements to the client separate and apart from those the qualified custodian sends. If the adviser does send clients its own account statements, however, the adviser must include a notice in the statement, when opening an account for a client and when sending subsequent account statements to the same client, urging the client to compare the account statements from the qualified custodian with those from the adviser.

33 Rule 206(4)-2(b)(4)(i).

34 Rule 206(4)-2(b)(4)(i).

35 Rule 206(4)-(2)(b)(4)(i). *See* Investment Advisers Act Release No. 2968 (Dec. 30, 2009) 75 FR 1456 (Jan. 11, 2010) at footnote 45 (stating that, although the custody rule requires an adviser relying on the audit approach to distribute financial statements to investors within 120 days, the Commission's most recent custody rule amendments did not affect the staff's views expressed in a 2006 no-action letter in which the staff stated it would not recommend enforcement action against an adviser to a fund of funds that distributed the financial statements within 180 days). *See* ABA Subcommittee on Private Investment Entities, SEC Staff Letter, Aug. 10, 2006.

36 Rule 206(4)-(2)(b)(4)(ii).

37 Rule 206(4)-2(b)(4)(iii). In order to use the audit approach, an adviser to a pooled investment vehicle must distribute audited financial statements to the pooled investment vehicle's investors upon the pool's liquidation.

- The adviser requested investor approval to waive the annual financial audit of a fund—but did not obtain a surprise examination.[38] The adviser, therefore, failed to either undergo a surprise exam or comply with the audit approach.

In addition to the deficiencies found in this set of examinations, registrants should also be aware that the staff has observed that advisers to some PIVs may be using financial statements for those PIVs to satisfy the custody rule's audit approach that are not prepared in accordance with U.S. GAAP or audited in accordance with U.S. Generally Accepted Auditing Standards as described in the 2003 Custody Rule Adopting Release, without satisfying the conditions set out in that guidance.[39] For example, the staff has observed instances in which the PIV's audit was not conducted in accordance with U.S. Generally Accepted Auditing Standards and/or the financial statements prepared in accordance with International Financial Reporting Standards did not contain information substantially similar to statements prepared in accordance with U.S. GAAP (e.g., the Schedule of Investments or Financial Highlights were omitted, or included but were labeled as unaudited).

Conclusion

The Advisers Act custody rule is designed to protect and safeguard client assets. Advisers may want to consider their policies and procedures and their compliance with the custody rule in light of the deficiencies noted in this Alert. Deficiencies in this area have resulted in actions ranging from immediate remediation to enforcement referrals and subsequent litigation.

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[38] Rule 206(4)-2(b)(4).

[39] *See* Footnote 41 of the 2003 Custody Rule Adopting Release; *See also* Staff Responses to Questions About the Custody Rule, Question VI 5, available at http://www.sec.gov/divisions/investment/custody_faq_030510.htm (providing staff guidance to pooled vehicles organized outside of the United States, or having a general partner or other manager with a principal place of business outside the United States, to allow them to use the "audit approach" even if they have their financial statements prepared in accordance with accounting standards other than U.S. GAAP so long as they contain information substantially similar to statements prepared in accordance with U.S. GAAP and meet certain other conditions).

NEP staff also welcomes comments and suggestions about how the Commission's examination program can better fulfill its mission to promote compliance, prevent fraud, monitor risk, and inform SEC policy. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify us at http://www.sec.gov/complaint/info_tipscomplaint.shtml.

This Risk Alert is intended to highlight for firms risks and issues that the staff has identified in the course of examinations regarding investment advisers' obligations when they maintain custody of client assets. In addition, this Risk Alert describes factors that firms may consider to (i) assess their supervisory, compliance and/or other risk management systems related to these risks and issues, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. These factors are not exhaustive, and they constitute neither a safe harbor nor a "checklist." Other factors besides those described in this Risk Alert may be appropriate alternatives or supplements to consider. The risks, issues and associated factors described are for informational purposes only. They do not necessarily represent legal or regulatory requirements. They do not present any legal opinion or advice. Moreover, future changes in laws or regulations may supersede some or all of the discussion in this Alert. Some of these risks, issues and associated factors may not be applicable to a particular firm given the characteristics of its business or operations. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

NATIONAL EXAM PROGRAM
OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

Examination Priorities for 2013

February 21, 2013

I. Introduction

The National Examination Program ("NEP") is publishing its examination priorities to communicate with investors and registrants about areas that are perceived by the staff to have heightened risk, and to support the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. These priorities, while set by the staff rather than by the Commission, are aligned with the SEC's mission by seeking to improve compliance, prevent fraud, inform policy, and monitor firm-wide and systemic risk.

The examination priorities and focus areas for 2013 were selected collaboratively by senior exam staff and management from the NEP's twelve offices, as well as senior representatives of other SEC divisions and offices, based upon an assessment of a variety of information, including:

- Information reported by registrants in required filings with the Commission;
- Information gathered through examinations conducted by the NEP and other regulators;
- Communications with other U.S. and international regulators and agencies;
- Industry and media publications;
- Comments and tips received directly from investors and registrants;
- Data maintained in third party databases; and
- Interactions with registrants, industry groups, and service providers (outside of examinations).

The NEP's examination priorities address issues that span the entire market, as well as issues that relate specifically to particular business models and organizations. The market-wide priorities are addressed first, followed by the priorities for each of the NEP's four distinct program areas: (i) investment advisers and investment companies, (ii) broker-dealers, (iii) clearing and transfer agents, and (iv) market oversight.

The priorities set forth in this memorandum are not exhaustive: while the NEP expects to allocate a significant portion of its resources throughout 2013 to the examination of the issues described below, the NEP will conduct additional examinations in 2013 focused on risks, issues, and policy matters that are not addressed here. Similarly, the NEP may focus its resources on a subset of the risks and issues identified here. Coordination with other federal and state regulators, as well as regulators from other nations, may also result in adjustments to these priorities.

II. NEP-Wide Initiatives

There are several risk areas and examination priorities that apply to nearly all registrants. These topics are described immediately below in general terms. More specific discussions of these and other topics are reviewed in the following sections, broken out by program area. The most significant initiatives across the entire NEP include:

Fraud Detection and Prevention. Our Nation's capital markets run, in large part, on trust. Nothing is more lethal to that trust than loss of investor capital for anything other than knowingly assumed risk, including scams, theft, and other fraudulent conduct. In its risk-based approach to targeting registrants and business practices, the NEP will continue to utilize and enhance its quantitative and qualitative tools and analyses to seek to identify market participants engaged in fraudulent or unethical behavior. The NEP also encourages tips, complaints, and referrals from investors, registrants, and other parties to help it identify potential frauds that harm investors and erode trust.

Corporate Governance and Enterprise Risk Management. The NEP will continue to meet with senior management and boards of entities registered with the Commission and their affiliates to discuss enterprise risk, and in particular, how a firm govern and manage financial, legal, compliance, operational, and reputational risks. This initiative is designed to: (i) understand firms' approach to enterprise risk management; (ii) evaluate firms' tone at the top; and (iii) initiate a dialogue on key risks and regulatory requirements. This effort provides the NEP with an opportunity to assess overall risk management at certain registrants through discussions with independent board members, senior management, internal audit, key risk and control functions, and leaders of business lines. It is also designed to better inform our examinations of such firms, as well as other registrants. The staff will also continue to engage in "discovery" reviews to inform both examination policy and rulemaking efforts and joint monitoring efforts with other regulators. For example, the Commission has joined the Federal Reserve in monitoring reform of tri-party repurchase agreements and practices. In addition, last fall Hurricane Sandy brought to light certain gaps in some registrants' business continuity plans. The staff is identifying the overall impact of the hurricane on certain entities' operations, including the obstacles they confronted when implementing their business continuity plans.

Conflicts of Interest. Conflicts of interest, when not eliminated or properly mitigated and managed, are a leading indicator and cause of significant regulatory issues for individuals, firms, and sometimes the entire market. Over the past several years, the NEP has identified conflicts of interest as a key focus of its risk-based strategy, and an integral part of our assessment of which firms to examine, what issues to focus on, and how to examine those areas. Conflicts of interest are a particularly important challenge for large and complex financial institutions. Due to these firms' extensive affiliations, and the dynamic nature of their businesses, conflicts are constantly arising and changing. The NEP will focus on specific conflicts of interest, steps registrants have taken to mitigate conflicts, and the sufficiency of disclosures made to investors. The staff will also look at the overall risk governance framework that firms have in place to manage conflicts on an ongoing basis.

Technology. The capital markets have experienced an ongoing revolution in technology over several decades, and the increasing complexity, interconnectedness, and speed fostered by technology is a continual challenge to market participants and regulators. A number of market events over the past two years have underscored how important it is for the Commission and other regulators to stay current on new trading technologies and their implications for maintaining transparent, stable markets that do not give inappropriate advantages to some market participants over others. In 2013, the NEP may conduct examinations on governance and supervision of information technology systems for topics such as operational capability, market access, and information security, including risks of system outages, and data integrity compromises that may adversely affect investor confidence. Among other things, the NEP hopes that these examinations will help the industry and the Commission to better understand operational information technology risks and potential methods to help mitigate and effectively manage those risks.

III. Program Area Specific Initiatives

This section discusses risks faced by specific program areas of the NEP. The focus areas are generally divided into ongoing risks, new and emerging risks, and policy topics.

"Ongoing risks" are those risk areas that are common to all or many of the business models utilized by a particular category of registrant and that have existed for a sustained period and are likely to continue to be risks for the foreseeable future. Certain of these ongoing risks have been selected as focus areas in 2013 because of the inherent risk they present or their reoccurrence in recently conducted examinations.

"New and emerging risks" are issues and business practices that pose an increased risk due to changes and developments in the industry, including significant changes in financial conditions, new products or investment strategies, technology, regulation, business combinations, and business practices.

"Policy topics" are areas in which the NEP has an interest in gaining a better understanding of particular practices or learning the practical application of previously adopted rules and guidance.

<u>Investment Adviser-Investment Company Exam Program</u>

The Investment Adviser-Investment Company ("IA-IC") Program has primary examination authority for approximately 11,000 registered investment advisers and 800 registered investment company complexes. Collectively, these entities manage nearly $50 trillion for investors.

A. IA-IC Program Examination Focus Areas

The scope of an IA-IC examination is generally limited to the issues and business practices of the registrant that are perceived by the staff to present the highest risks to investors and the integrity of the market. Thus, the scope of exams will vary from registrant to registrant. Nevertheless, across the program, there are certain issues that predominate. In addition to the specific risk areas unique to each registrant, the staff will consider the following focus areas when scoping and conducting examinations in 2013.

- **<u>Ongoing Risks</u>.**

The staff anticipates that the ongoing risks selected as focus areas for IA-ICs in 2013 will include:

<u>Safety of Assets</u>. As it has in the past, the staff will continue to utilize a risk-based asset verification process to confirm the safety of client assets and compliance with custody requirements. The staff will

review the measures taken by registrants to protect client assets from loss or theft, the adequacy of audits of private funds, and the effectiveness of policies and procedures in this area. Recent examinations of investment advisers have found a high frequency of issues regarding the custody and safety of client assets under Advisers Act Rule 206(4)-2 (the "Custody Rule"). Therefore the staff will focus on issues such as whether advisers are: (i) appropriately recognizing situations in which they have custody as defined in the Custody Rule; (ii) complying with the Custody Rule's "surprise exam" requirement; (iii) satisfying the Custody Rule's "qualified custodian" provision; and (iv) following the terms of the exception to the independent verification requirements for pooled investment vehicles.

<u>Conflicts of Interest Related to Compensation Arrangements</u>. The staff will review financial and other records to identify undisclosed compensation arrangements and the conflicts of interest that they present. These activities may include undisclosed fee or solicitation arrangements, referral arrangements (particularly to affiliated entities), and receipt of payment for services allegedly provided to third parties. For example, some advisers that place client assets with particular funds or fund platforms are, in return, paid "client servicing fees" by such funds and fund platforms. Such arrangements present a material conflict of interest that must be fully and clearly disclosed to clients.

<u>Marketing/Performance</u>. Marketing and performance advertising is an inherently high-risk area due to the highly competitive nature of the investment management industry. Aberrational performance of certain registrants and funds can be an indicator of fraudulent or weak valuation procedures or practices. The staff will also focus on the accuracy of advertised performance, including hypothetical and back-tested performance, the assumptions or methodology utilized, and related disclosures and compliance with record keeping requirements. Where feasible, the staff will also review changes in advertising practices related to the JOBS Act, which requires modification of the rules restricting general solicitations.

<u>Conflicts of Interest Related to Allocation of Investment Opportunities</u>. Advisers managing accounts that do not pay performance fees (*e.g.*, most mutual funds) side-by-side with accounts that pay performance-based fees (*e.g.*, most hedge funds) face unique conflicts of interest. While reviewing portfolio management practices, the staff will confirm that the registrant has controls in place to monitor the side-by-side management of its performance-based fee accounts, such as certain private investment vehicles, and registered investment companies, or other non-incentive fee-based accounts, with similar investment objectives, especially if the same portfolio manager is responsible for making investment decisions for both kinds of client accounts or funds.

<u>Fund Governance</u>. Fund governance and assessing the "tone at the top" is a key component in assessing risk during any investment company examination. The staff will confirm that advisers are making full and accurate disclosures to fund boards and that fund directors are conducting reasonable reviews of such information in connection with contract approvals, oversight of service providers, valuation of fund assets, and assessment of expenses or viability.

- **<u>New and Emerging Issues</u>**.

The staff anticipates that the new and emerging risks for IA-ICs in 2013 will include:

New Registrants. Since the effective date in early 2012 of Section 402 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, approximately 2,000 investment advisers have registered with the SEC for the first time. The vast majority of these new registrants are advisers to hedge funds and private equity funds that have never been registered, regulated, or examined by the SEC. The IA-IC Program therefore intends to launch a coordinated national examination initiative designed to establish a meaningful presence with these newly registered advisers. The initiative is expected to run for approximately two years and consists of four phases: (i) engage with the new registrants; (ii) examine a substantial percentage of the new registrants; (iii) analyze our examination findings; and (iv) report to the industry on our observations. In addition to the new registrant initiative, the IA-IC Program will also prioritize examinations of private fund advisers where the staff's analytics indicate higher risks to investors relative to the rest of the registrant population, or there are indicia of fraud or other serious wrongdoing.

Dually Registered IA/BD. Due to the continued convergence in the investment adviser and broker-dealer industry, the IA-IC Program will continue to expand coordinated and joint examinations with the B-D Program of dually registered firms and distinct broker-dealer and investment advisory businesses that share common financial professionals. For example, it is not uncommon for a financial professional to conduct brokerage business through a registered broker-dealer that she does not own or control and to conduct investment advisory business through a registered investment adviser that she owns and controls, but that is not overseen by the broker-dealer. This business model presents multiple conflicts. Among other things, the staff will review how financial professionals and firms satisfy their suitability obligations when determining whether to recommend brokerage or advisory accounts, the financial incentives for making such recommendations, and whether all conflicts of interest are fully and accurately disclosed. In addition, the staff will review dually registered firms' policies and procedures to understand if such policies and procedures provide guidelines for when a financial professional makes a securities recommendation to a customer with a broker-dealer account versus an investment adviser account.

"Alternative" Investment Companies. The IA-IC Program is focusing on the growing use of alternative and hedge fund investment strategies in open-end funds, exchange-traded funds ("ETFs"), and variable annuity structures. More specifically, the staff will assess whether: (i) leverage, liquidity and valuation policies and practices comply with regulations; (ii) boards, compliance personnel, and back-offices are staffed, funded, and empowered to handle the new strategies; and (iii) the funds are being marketed to investors in compliance with regulations.

Payments for Distribution in Guise. The IA-IC Program is focusing on the wide variety of payments made by advisers and funds to distributors and intermediaries, the adequacy of disclosure made to fund boards about these payments, and boards' oversight of the same. These payments go by many names and are purportedly made for a variety of services, most commonly revenue sharing, sub-TA, shareholder servicing, and conference support. The staff will assess whether such payments are made in compliance with regulations, including Investment Company Act Rule 12b-1, or whether they are instead payments for distribution and preferential treatment.

- **Policy Topics.**

The staff anticipates that the policy topics for IA-ICs will include:

Money Market Funds. Recent amendments to Investment Company Act Rule 2a-7 require money market funds to periodically stress test their ability to maintain a stable share price based on hypothetical events, including changes in short-term interest rates, increased redemptions, downgrades and defaults, and changes in spreads from selected benchmarks. Among other things, the staff will review whether firms are conducting stress testing, what factors they are considering in the stress testing, and the results of the stress testing.

Compliance with Exemptive Orders. Where applicable, the staff will focus on compliance with previously granted exemptive orders, such as those related to closed-end funds and managed distribution plans, employee securities companies, ETFs and the use of custom baskets, and those granted to fund advisers and their affiliates permitting them to engage in co-investment opportunities with the funds.

Compliance with the Pay to Play Rule. To prevent advisers from obtaining business from government entities in return for political "contributions" (i.e., engaging in pay to play practices), the SEC recently adopted and subsequently amended, the Pay to Play rule. The staff will review for compliance in this area, as well as assess the practical application of the rule.

Broker-Dealer Exam Program.

The Broker-Dealer ("B-D") Program operates the Commission's examination program for more than 4600 registered broker-dealers with approximately 111 million customer accounts, over 160,000 branch offices, and over 630,000 registered representatives. The B-D Program applies a risk-targeted focus to the program and also assists in selecting particular broker-dealers for examination, taking into account: (i) the risks and activities associated with individual broker-dealers (or firms); and (ii) the risks identified in the course of regional risk assessment efforts. The B-D Program also coordinates closely with the Financial Industry Regulatory Authority ("FINRA") and state regulators.

B-D reviews may involve activities by enterprises with related entities registered in multiple capacities (*i.e.*, broker-dealer, investment adviser, transfer agent, etc.) acting in concert. The staff will reach out as necessary to the relevant program within the NEP and elsewhere to ensure that exam activities as well as ensuing investigations are properly coordinated.

A. B-D Program Examination Focus Areas

B-D examinations are primarily focused on issues and business practices that are perceived by the staff to present the highest risks to investors and the integrity of the market. For example, in 2012 a large number of issues centered around capital and financial controls of B-Ds. Exam scopes will vary from registrant to registrant, depending on the registrant's business activity and the risk associated with such activity. Nevertheless, across the program, certain issues predominate. In addition to the specific risks unique to each registrant, the staff will consider the following focus areas when scoping and conducting examinations in 2013.

- **Ongoing Risks**

The staff anticipates that the ongoing risks that will be focus areas for B-Ds in 2013 include:

Sales Practices/Fraud. The B-D Program frequently finds fraud in connection with sales practices regarding retail investors, including:

- Affinity fraud or fraud targeting seniors;
- Unsuitable recommendations of higher yield products (e.g., unsuitable recommendations of municipal or corporate bonds), as well as improper supervision and due diligence processes regarding those recommendations or those products;
- Activities and products on the periphery of certain registered entities, such as outside business activities or an affiliated entity that the registrant claims is beyond the Commission's jurisdiction;
- Conflicts of interest that are not appropriately mitigated, and are not clearly disclosed in an understandable and timely manner; and
- Certain firms identified as recidivist or high-risk for potential misconduct.

Trading. The exact nature of trading risks tends to evolve over time as new technologies and market practices develop. For example, high-frequency and algorithmic trading, taken in isolation, might be considered a relatively new risk; however, trading risks are an ongoing challenge for individual firms and for the financial system precisely because market structures and practices are always dynamic and evolving. The staff intends to address certain trading risk areas, with particular focus on high frequency trading, algorithmic trading, proper controls around the use of technology, alternative trading systems and order routing practices.

Capital. The B-D Program intends to conduct exams of clearing firms with multiple correspondents engaging in high frequency/high volume trading, focusing on the clearing firms' internal controls for managing intraday liquidity risk, as well as assessing intraday net capital and other financial risks.

AML. The staff will identify clearing and introducing firms that appear to have weak anti-money laundering ("AML") programs, especially customer identification programs (CIP), suspicious activity identification and reporting deficiencies, and weak due diligence procedures regarding certain accounts. The B-D Program will focus on the firm's risk assessment of its business practices and implementation of the AML program related to those risks, including risks associated with taking on the accounts of failed or expelled firms.

➢ **New and Emerging Issues**

In addition to the joint examinations of dually registered IA-BDs with the IA-IC Program described above, the staff anticipates that new and emerging issues for the B-D program for 2013 will include:

Exchange Act Rule 15c3-5, (the Market Access Rule). The staff will focus on firms' compliance with this rule, with particular attention to master/sub-accounts relations and proper controls relating to proprietary trading. Some areas of particular focus:

- Master / Sub-Accounts: The structure of this model lends itself to potential issues related to money laundering activity, market manipulation, unregistered broker-dealers, excessive margin, and inadequate minimum equity for pattern day traders. Staff will also look at the adequacy of books and records maintained by broker-dealers that provide market access;

- Proprietary Trading: Some firms are unaware that the Rule applies to, and requires capital thresholds on, proprietary trading, including error accounts. These thresholds must also encompass a methodology for accounting for open quotes, taking into account quotes associated with market making activities;
- Supervision of Registrants' Technology System Controls and Governance: The staff has observed a series of technology system problems that have caused firms' significant losses and eroded customer confidence in the markets. These technology system errors have occurred at both the exchange level as well as at multiple broker-dealers. These events have raised questions as to the effectiveness of broker-dealers' controls and oversight over technology systems and supervision of personnel, as well as the adequacy of firms' protocols to address systems that are acting counter to expectations, and the robustness of firms' risk management procedures; and
- Dual Registrants/ Regulatory Coordination: In the aftermath of notable problems encountered in the past year by certain broker-dealers dually registered as futures commission merchants, the B-D Program will maintain its focus in this area in coordination with the Commodity Futures Trading Commission ("CFTC"). More broadly, the B-D Program is emphasizing stronger coordination among Designated Examination Authorities.

Exchange-Traded Funds. Recent examinations have highlighted certain issues risks relating to ETFs , such as fails to deliver and compliance with Regulation SHO. In addition, the B-D Program will continue to review the suitability of recommendations of leveraged or inverse ETFs to retail investors.

➢ **Policy Topics**

The staff anticipates that the policy topics in the B-D program for 2013 will include:

JOBS Act. Upon approval of a final rule relating to the JOBS Act, which creates a new exemption from registration under the Securities Act for qualified "crowd funding" transactions, the staff intends to conduct reviews of entities participating in the crowd funding business, as appropriate.

Other Regulatory Requirements. The staff intends to assess compliance with the new registration and related rules applicable to municipal advisors as well as incentive compensation, pending adoption of final rules. Also, the staff intends to conduct examinations for compliance with Security-Based Swap Dealers rules pending the final adoption or compliance effective date for such rules.

Market Oversight Exam Program

OCIE's Office of Market Oversight is responsible for examining certain SROs and other entities to evaluate their compliance with applicable Federal securities laws and rules and the SRO's own rules. The SROs subject to Market Oversight's review include the national securities exchanges (both equity and options market centers), FINRA, and the Municipal Securities Rulemaking Board. Market Oversight also oversees the Public Company Accounting Oversight Board and the Securities Investor Protection Corporation. The staff anticipates that its risk-based exam focus in 2013 will include the following priorities:

Risk Assessment Examinations of Exchanges. Market Oversight will conduct targeted, risk focused SRO examinations. Through recent assessment examinations of each SRO, Market Oversight has established a baseline for comparing the effectiveness of compliance programs across the SROs. As part of its risk evaluation, Market Oversight has identified several specific areas for examination in 2013. Among these are examinations of equity exchanges to review the internal controls and governance around each exchange's rule making process and the supervision of regulatory service agreements by exchanges. In addition, as described below, Market Oversight will monitor closely industry developments and specific events to further enhance risk assessments and focus.

FINRA Oversight. Market Oversight will continue its efforts to enhance oversight of FINRA. As part of a risk-based approach to overseeing FINRA, the staff will evaluate and prioritize evolving and varying risks at FINRA to identify areas for review. The staff will consider both those program areas specifically outlined in Dodd-Frank Section 964, as well as areas not articulated in Section 964 for possible oversight.

Examinations of New Registrants. Market Oversight plans to inspect recently registered exchanges and will continue to meet with entities intending to register as an exchange. Market Oversight also will incorporate into its examination plan review of security-based swap execution facilities if the Commission adopts final rules requiring their registration.

Regulatory Responsibility Examinations. Market Oversight plans to continue its review of the SROs' obligations to enforce member compliance with financial responsibility requirements.

SRO Monitoring. To supplement its examination efforts, Market Oversight, along with the Division of Trading and Markets ("TM"), monitors the SROs' activities on an on-going basis. The monitoring functions include coordination with the SROs through joint regulatory conferences, evaluation of oversight issues identified through staff's broker-dealer examinations, and collaboration with TM on review of SRO activities and with the Division of Enforcement on related investigations. Market Oversight also reviews significant market events with the assistance of the SROs. Market Oversight conducts these activities, in part, to identify emerging risks and to work with the SROs on effective, real time mitigation strategies.

Systems Compliance. Market Oversight will continue to review and examine systems outages, systems errors, and system integrity through SRO self-reporting. Market Oversight also will continue to coordinate the interdisciplinary Market Event Response Team, which examines market events in real time.

Order Type Assessments. Market Oversight will conduct inspections of equities exchanges to determine the types of orders available and the internal governance process around how order types are proposed, implemented, and monitored post-implementation.

Clearance and Settlement Exam Program

The Clearance and Settlement Program currently consists of two registrant types and associated exam programs: Transfer Agents and Clearing Agencies.[1]

A. Transfer Agent Program

The Transfer Agent Program has examination authority for approximately 460 transfer agents consisting of both SEC-registered (approximately 75% of the transfer agent population) and bank-registered transfer agents. The full transfer agent population maintains over 306 million shareholder accounts for approximately 1.7 million issuers (including equity, debt, and mutual fund securities) as reported for the end of 2011. In addition to core transfer agent services (defined below), certain transfer agents may provide paying agent services, which reported at the end of 2011 distributing over $1.8 trillion in shareholder dividends and interest payments.

- **Ongoing Risks**.

The staff anticipates that ongoing risks that will be focus areas for transfer agents in 2013 include:

Transfer Agent Core Activities. Most, if not all, transfer agents engage in three core activities: the timely turnaround (elapsed time it takes to process) of items and transfers (Exchange Act Rule 17Ad-2); accurate recordkeeping and associated retention (Exchange Act Rules 17Ad-6 and 17Ad-7); and safeguarding funds and securities (Exchange Act Rule 17Ad-12). Compliance with these core transfer agents' regulations are a general indication of the compliance environment of the transfer agent; therefore, the exam staff will focus on compliance and controls in these critical core activities.

Transfer Agent Safeguarding. Certain transfer agent services may heighten the risk of investor loss, such as paying agent activities located in non-bank registered transfer agents (which may involve the handling of millions of dollars of investor funds) and direct securities transactions in which a transfer agent accepts shareholder orders (*e.g.*, employee stock plans). In addition, transfer agents that offer purchase and sale services may increase the risk of engaging in unregistered broker-dealer or investment adviser activity if they offer, for example, investment advice. The staff will focus on whether transfer agents provide appropriate customer service without offering investment advice that would require the transfer agent to register as either a broker-dealer or an investment adviser.

Transfer Agent Recordkeeping and Retention. While recordkeeping and retention is a core activity for all transfer agents, certain events could elevate the potential risks surrounding these processes. The staff will review whether transfer agents have policies and procedures that include, for example: business continuity procedures related to facility or other business impediments; electronic storage, appropriate redundancy, and timely retrieval for the required regulatory periods; and third-party vendor access and security.

[1] Security-based Swap Data Repositories ("SDRs") will be incorporated into the Clearance and Settlement Program once these entities are required to register with the Commission pursuant to regulations enacted under the Dodd-Frank Act. In the event that further rulemaking occurs during 2013 affecting SDRs, NEP staff will review draft rules and standards to provide the examination perspective.

Transfer Agent Size, Volume, and Experience. The size of, volumes processed by, and experience of, a transfer agent may also indicate heightened risks. For example, a transfer agent with a staff of only one or two may have an enhanced risk profile caused by key person risk. Additionally, the risk potential may increase as transfer agents service more issuers or handle increased numbers of transfers. The staff has also observed that newly-registered transfer agents generally pose an increased risk, as they may not fully understand the requirements of applicable regulations.

- **New and Emerging Issues**.

The staff anticipates that new and emerging risks for the Transfer Agent Program in 2013 will include:

Microcap Securities and Private Offerings. Transfer agents that service microcap securities, especially those involved in private offerings, may be used to facilitate the unregistered offering of restricted securities by allowing securities transfers that could circumvent existing rules or enable fraudulent schemes. To help prevent the facilitation of these unlawful schemes, the staff will evaluate whether transfer agents have effectively implemented formal written policies and procedures for the appropriate removal of restrictions on microcap securities. As conflicts of interest increase the potential for this risk, the staff will review whether these policies and procedures include, for example, an understanding of roles of the other parties involved with the transactions (*e.g*., attorneys, brokers, control persons, etc.), the identification of potential conflicts associated with those parties, as well as appropriate actions to be taken where conflicts may be identified.

Microcap securities and private offerings are also a priority for the B-D Program, as discussed above. The staff in both units will coordinate their activities.

Conflicts of Interest. Potential conflicts of interest may arise if the transfer agents' principals are owners of or affiliated with issuers, vendors, or others involved in the transfer agents' activities (*e.g*., attorneys, brokers, etc.). The staff will examine whether transfer agents have implemented effective formal written policies and procedures to identify, disclose, where appropriate, and mitigate conflicts where those conflicts could lead to unlawful activities.

Hybrid Securities. As the securities industry evolves, new types of securities increase the risk that transfer agents' existing procedures and operations do not appropriately reflect the characteristics of these new securities. Some of the hybrid securities that combine characteristics of equity and debt securities include, for example, preferred shareholder classes, convertible securities, and equity warrants or options. The staff will review whether transfer agents have implemented effective formal written policies and procedures that reflect ***all*** types of securities serviced by the transfer agent (including those that are new or complex) and can demonstrate an in-depth understanding of the instructions required for transfers and/or conversions of those security types.

Outsourcing. Transfer agents, similar to other financial service firms, may outsource certain activities to other registered transfer agents or, depending on the activity, other types of financial intermediaries. In addition, larger transfer agents may establish "off-site" processing centers in out-of-state or non-US locations. The staff will examine whether transfer agents that outsource services have implemented effective formal written policies and procedures and appropriate contractual clauses (or service level agreements) that, for example, help monitor, ensure, and maintain the appropriate processing environment for meeting their regulatory obligations and allow for timely and accurate production of books and records.

Third Party Administration. Some registered transfer agents provide services generally known as "third party" administration. "Third party" administration services are similar to transfer agent recordkeeping functions but are performed for parties other than the issuer of a Section 12 security, (*e.g.*, a retirement plan). These recordkeeping activities are generally related to either a specific plan or performing services in conjunction with a mutual fund company and keeping plan members' records at the omnibus level with the mutual funds' transfer agents. As these third party administrators often accept and route plan-member orders, the staff will review whether these registrants have effectively implemented policies and procedures that evaluate their activities to help identify when the activities may require either broker-dealer or investment adviser registration. In connection with IA-IC examinations, the staff will also ask for information on third-party administrators, and may use this information to consider whether entities that provide these services are appropriately registered or exempt from registration.

- **Policy Topics**.

The Transfer Agent Program may review areas in order to understand better the practices of transfer agents, which will help examination staff in informing the drafting of new rules (e.g., potential rule writing by the Commission regarding the JOBS Act), or review the effects of any new regulation for transfer agents, if adopted, and associated compliance. Additionally, the policy divisions may request the examination staff to review practices related to pending or implemented industry initiatives (for example, dematerialization, proxy reform, and escheatment practices).

B. Clearing Agency Program

In July 2012, Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC"), Fixed Income Clearing Corporation ("FICC"), and Options Clearing Corporation ("OCC") were designated as systemically important by the Financial Stability Oversight Council under the Dodd-Frank Act with the SEC as the primary supervisory agency. Additionally, CME Group ("CME") and ICE Clear Credit were designated as systemically important with the CFTC as primary supervisory agency.

The Dodd-Frank Act requires all systemically designated clearing agencies to be examined annually by their primary supervisory agency. The staff will perform its first annual examination of DTC, NSCC, FICC, and OCC in 2013, in accordance with the requirements of the Dodd- Frank Act. It is anticipated that CFTC will request the staff to participate in its annual examination of CME and ICE Clear Credit. For the two non-designated clearing agencies, the staff will consider the level, nature, and timing of any examination activity based upon a risk approach.

For 2013, the staff anticipates that it will focus on the following areas:

Performance of Annual Exams Mandated by the Dodd-Frank Act. The performance of the required annual examination will utilize a risk-based approach to determine the policies, procedures, and associated internal controls to be reviewed and evaluated. This approach will incorporate, where appropriate, new rules and standards adopted; input as a result of collaboration and coordination with TM and other regulators (the Federal Reserve Board, the Federal Reserve Banks of New York and Chicago and the CFTC, where applicable); and experience with the clearing agencies through monitoring and/or prior examination activities. The staff also will consider the requirements pursuant to Section 17A of the Exchange Act and the rules thereunder and where applicable the following factors defined by the Dodd-Frank Act:

- The nature of the operations and the risks borne by the designated clearing agency;
- The financial and operational risks presented by the designated clearing agency to financial institutions, critical markets, or the broader financial system;
- The resources and capabilities of the designated clearing agency to monitor and control such risks;
- The safety and soundness of the designated clearing agency; and
- The designated clearing agency's compliance with the Dodd-Frank Act and rules and orders prescribed under the Dodd-Frank Act.

Performance of Monitoring Activities. To the extent possible, regular interaction with designated clearing agencies, in addition to examination activities, is beneficial when considering the potential risks and factors defined by the Dodd-Frank Act. Such monitoring activities could include:

- Periodic discussions with the Board, Senior Management, the head of internal control functions (e.g., the General Auditor, Chief Risk Officer, and Chief Compliance Officer).
- Review of risk management reports (e.g., back and stress tests), internal audit reports, compliance reports, incident reports, new initiatives committee documentation, and other similar documentation, where applicable and periodically as issued.
- Participation in and/or review of information regarding meetings held by TM's Risk Monitoring group and the staff responsible for the Commission's Automation Review Policy Program.
- Collaboration and periodic information sharing with other regulators.

Informing Policy and Process. In the event that further rulemaking continues in 2013 affecting clearing agencies, the staff will review draft rules and standards to provide the examination perspective. Additionally, the staff will enhance / tailor the clearing agency exam procedures and processes, where appropriate during the fiscal year, to incorporate the new requirements and the consultation, where applicable, of TM and/or other regulators.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS
100 F STREET, NE
WASHINGTON, DC 20549

October 9, 2012

Dear Senior Executive or Principal of a Newly Registered Investment Adviser:[1]

We are sending you this letter to introduce you to the National Exam Program ("NEP"), which is administered by the Office of Compliance Inspections and Examinations ("OCIE") within the United States Securities and Exchange Commission ("Commission"), and to provide you with information about upcoming examinations of certain newly registered investment advisers and the topical areas that may be examined.[2] ***The NEP staff will contact you separately if your firm is selected for an examination.***

I. Information About the NEP

An investment adviser registered with the Commission has an obligation to comply with the Investment Advisers Act of 1940 (the "Advisers Act") and the rules adopted by the Commission thereunder. OCIE examines registered advisers, including firms that advise private funds, to assess whether they are operating in a manner consistent with the federal securities laws. OCIE administers such examinations through the NEP, which is comprised of staff in the Commission's 11 regional offices and the home office in Washington, D.C. The NEP's mission is to protect investors and maintain market integrity through risk-focused examinations that promote compliance, prevent fraud, monitor risk, and inform policy.

II. Presence Exams of Certain Newly Registered Investment Advisers

Consistent with our mission and objectives, the NEP is launching an initiative to conduct focused, risk-based examinations of investment advisers to private funds that recently registered with the Commission ("Presence Exams"). The Presence Exams initiative will take place over the next two years and it has three primary phases: engagement; examination; and reporting. Each phase is described further below.

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1 For purposes of this letter, we distinguish an investment adviser as "newly registered" if it registered with the Commission after the definitional and transitional rules under Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 became effective (July 21, 2011). In addition, this letter is specifically directed to senior officers of investment advisers that manage private funds.

2 The Commission, as a matter of policy, disclaims responsibility for any publication or statement by any of its employees. The views expressed herein are those of the staff and do not necessarily reflect the views of the Commission or the other staff members of the Commission.

A. Engagement Phase

The NEP is engaged in a nationwide outreach to inform newly registered firms about their obligations under the Advisers Act and related rules, the Presence Exams initiative, and OCIE's practice of engaging directly with firms' senior management. As part of our outreach initiatives, the NEP has published compliance outreach materials, staff letters, risk alerts, special studies, speeches, and other documents that are available on the Commission's website.[3] The Commission's website also contains information and links to relevant laws and rules, staff guidance, enforcement cases, and staff issued no-action and interpretive letters (generally from 2001 to present).[4] Some of these resources and their reference links are provided at the end of this letter.[5]

In addition, the Commission's staff engages in compliance outreach for investment advisers through initiatives such as our Compliance Outreach Program. This program is designed to provide senior officers, including Chief Compliance Officers, with a forum to discuss compliance issues, share experiences, engage in discussions with Commission staff, and learn about effective compliance practices. The program features both regional meetings at various locations across the country and national seminars in Washington D.C.

B. Examination Phase

During the examination phase of the Presence Exams initiative, NEP staff will review one or more of the following higher-risk areas of the business and operations of advisers selected for an examination:[6]

Marketing. Investment advisers may utilize marketing materials to solicit new investors or retain existing investors. NEP staff will review marketing materials to evaluate whether the investment adviser has made false or misleading statements about its business or performance record; made any untrue statement of a material fact; omitted material facts; made any statement that is

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3 In particular, you are encouraged to review the staff's letter to newly registered investment advisers that was sent to your firm when it registered through IARD. For a more detailed overview of the NEP and the issues of focus for the examination staff, see recent speeches by OCIE's Director, Carlo di Florio, and former Deputy Director, Norm Champ.

4 Staff interpretations and no-action letters provided by the Commission's Division of Investment Management are informal interpretative and advisory assistance and represent the views of persons who are continuously working with the provisions of the Advisers Act. Opinions expressed by the staff, however, are not an official expression of the Commission's views and they do not have the force of law. You may wish to speak with an attorney or a compliance professional about specific provisions and how they apply to your firm.

5 This letter does not provide a complete description of all of the legal obligations of SEC-registered advisers nor does it provide a comprehensive inventory of resources that may be available.

6 The books and records of all registered investment advisers are subject to compliance examinations by Commission staff, including the records and reports of any private funds to which investment advisers registered under Advisers Act provide investment advice. If your firm is examined, you are required to provide examiners with access to all requested advisory records that are maintained by your firm (under certain conditions, documents may remain private under the attorney-client privilege).

otherwise misleading; or engaged in any manipulative, fraudulent, or deceptive activities. In addition, NEP staff will review how investment advisers solicit investors for the private funds they manage, including the use of placement agents.

Portfolio Management. An investment adviser has an obligation to act in the best interests of its advisory clients and to identify, mitigate, and disclose any material conflict of interest. NEP staff will review and evaluate investment advisers' portfolio decision-making practices, including the allocation of investment opportunities and whether advisers' practices are consistent with disclosures provided to investors.

Conflicts of Interest. The NEP staff will review the procedures and controls that advisers use to identify, mitigate, and manage certain conflicts of interest within their firms. Some areas of the conflicts of interest that NEP staff will review includes: allocation of investments, fees, and expenses; sources of revenue; payments made by private funds to advisers and related persons; employees' outside business activities and personal securities trading; and transactions by advisers with affiliated parties.

Safety of Client Assets. Registered investment advisers that have "custody" of client assets must take specific measures to protect client assets from loss or theft. NEP staff will review advisers' compliance with the relevant provisions of the Advisers Act and related rules that are designed to prevent the loss or theft of client assets. When obtained, NEP staff also will review independent audits of private funds for consistency with the Advisers Act custody rule.

Valuation. Investment advisers must have effective policies and procedures regarding the valuation of client holdings and assessment of fees based on those valuations. NEP staff will review advisers' valuation policies and procedures, including their methodology for fair valuing illiquid or difficult to value instruments. NEP staff also will review advisers' procedures for calculating management and performance fees, and allocation of expenses to private funds.

If your firm is selected for an examination, after the completion of the on-site portion of the examination, NEP staff may send you a letter indicating that the examination has concluded without findings or a letter that describes the deficiencies identified and asks your firm to undertake corrective action. If serious deficiencies are found, in addition to sending an examination summary letter, NEP staff may refer the problems to the Commission's Division of Enforcement, or to a self-regulatory organization, state regulatory agency, or other regulator for possible action.

C. Reporting Phase

At the conclusion of the Examination Phase, the NEP intends to report its observations to the Commission and the public. These observations may include common practices identified in the higher-risk focus areas, industry trends, and significant issues. In sharing examiners' observations from Presence Exams, the NEP staff hopes to encourage firms to review compliance in these areas and to promote improvements in investment adviser compliance programs.

* * *

We hope that this letter was useful in introducing you to the Presence Exams initiative and the examination program generally, and will better acquaint you and your personnel with compliance resources. Should you have any questions regarding this letter, please identify the Commission's regional office that is assigned to your advisory firm and contact any member of NEP management in that office.[7]

Sincerely,

Drew Bowden
Deputy Director

cc: Chief Compliance Officer

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7 Instructions regarding identifying the Commission's office applicable to your firm are provided in the attached "Additional Information: Reference Materials" guide in the section titled "Information Regarding the NEP and Examinations."

Additional Information: Reference Materials

You may find the following non-exclusive list of informational sources to be helpful. Items referenced by a "✓" below are highlighted in the letter.

Information About the Advisers Act

- The Advisers Act and rules are available on the Commission's website at http://www.sec.gov/divisions/investment.shtml).

- Overview of the Regulation of Investment Advisers (April 2012), available on the Commission's website at http://sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf

- SEC-Staff Issued Interpretive Guidance and Studies, available on the Commission's website at http://www.sec.gov/divisions/investment.shtml.

✓ Information for Newly-Registered Investment Advisers, available on the Commission's website at http://www.sec.gov/divisions/investment/advoverview.htm.

Information Regarding the NEP and Examinations

- Overview of Examinations by the Securities and Exchange Commission's Office of Compliance Inspections and Examinations (February 2012), available on the Commission's website at http://www.sec.gov/about/offices/ocie/ocieoverview.pdf

- Examination Brochure, available on the Commission's website at http://www.sec.gov/about/offices/ocie/ocie_exambrochure.pdf.

- NEP website, available at http://www.sec.gov/about/offices/ocie.shtml.

✓ Listing of local Commission office (contact information for senior examination staff) is available at http://www.sec.gov/about/offices/ocie/ocie_org.htm. The Commission's regional office designated for an adviser can be found by first identifying the adviser's Principal Office and Place of Business on its Form ADV (as used in: Form ADV, Part 1A, Instructions, Items 1 and 2; Schedule D; Form ADV-W, Item 1) and then identifying the Commission's regional office assigned to that state jurisdiction (which can be found at http://www.sec.gov/contact/addresses.htm).

Information Relevant to the Higher-Risk Topical Areas

✓ Speech by Commission Staff Carlo di Florio, "Address at the Private Equity International Private Fund Compliance Forum" (May 2, 2012), available on the Commission's website at http://sec.gov/news/speech/2012/spch050212cvd.htm#_ftnref2.

- ✓ Speech by Commission Staff Norm Champ, "What SEC Registration Means for Hedge Fund Advisers" (May 11, 2012), available on the Commission's website at http://sec.gov/news/speech/2012/spch051112nc.htm.

Information Regarding the Role of Senior Management in Compliance and Ethics

- Speech by Commission Staff Carlo di Florio, "The Role of Compliance and Ethics in Risk Management" (October 17, 2011), available on the Commission's website at http://www.sec.gov/news/speech/2011/spch101711cvd.htm.

- Speech by Commission Staff Stephen M. Cutler, "Second Annual General Counsel Roundtable: Tone at the Top: Getting it Right" (December 4, 2004), available on the Commission's website at http://www.sec.gov/news/speech/spch120304smc.htm.

Information About the Compliance Outreach Program

- Information about the Compliance Outreach Program for investment advisers and any scheduled events is available at http://www.sec.gov/info/complianceoutreach_ia-funds.htm.

Historical Observations by Commission Staff Regarding Hedge Funds

- Commission Staff report regarding the "Implications of the Growth of Hedge Funds" (September 2003), available on the Commission's website at http://www.sec.gov/news/studies/hedgefunds0903.pdf.

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Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

Current Hedge Fund Environment: Institutional Investor and Manager Perspectives

Jedd H. Wider

Louis H. Singer

Christopher J. Dlutowski

May 2, 2013

www.morganlewis.com

Valuations

- Standard Terms
  - Valuation process disclosed in Fund documents
  - Broad authority of GP/Manager to fair value
  - Valuation reports with ASC 820 classification limited to annual audited financial statements

Valuations (continued)

- Market Developments
  - Investor push for clarification of the roles of the GP/Manager and the administrator and for administrator values to control
  - Upfront disclosure of Manager’s valuation policy and intra-year valuation reports
  - Investor consultant or other third-party review of Fund valuation policies and procedures
  - In captive funds, investor challenges and the dispute process

Reporting and Other Disclosure

- Reporting
  - Standard Terms
    - Monthly performance estimates
    - Monthly capital statements
    - Quarterly performance reports
    - Annual audited financial statements

Reporting and Other Disclosure (continued)

- Reporting (cont.)
  - Market Developments
    - Weekly performance estimates
    - Monthly portfolio summaries, including:
      - gross long positions, gross short positions, and net positions by strategy, security type, geographic region, and sector
      - top five long positions and top five short positions
      - performance attribution
      - leverage levels
    - Monthly portfolio holdings reports on a real-time or lagged basis
    - Monthly risk reports provided through a risk aggregator

Reporting and Other Disclosure (continued)

– Market Developments (cont.)

- Monthly statements of management fees and performance compensation
- Monthly or quarterly valuation reports, including ASC 820 classification (highlight on Level 3 assets)
- Annual reconciliations of audit versus capital account statements
- Annual conflict of interest reports
- Annual compliance certificates
- Annual Fund-level tax reporting
- ERISA Section 408(b)(2) service provider disclosure
- Form PF

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Reporting and Other Disclosure (continued)

- Notice Requirements
  - Standard Terms
    - Material amendments of Fund documents
    - Certain amendments to Form ADV, as required under applicable securities laws and regulations
    - Key person events (not majority)

Reporting and Other Disclosure (continued)

- Notice Requirements (cont.)
  - Market Developments
    - Bad acts involving GP, Manager, or Investment Personnel
      - Breaches of standard of care/fiduciary duty
      - Breaches of Fund documents or side letters
      - Non-routine investigations or findings of violations of securities laws or regulations
      - Convictions, pleas of *nolo contendere* or guilty pleas to felonies or crimes involving fraud
      - Violations of other applicable laws, regulations, or investor policies, including ERISA (or comparable state law) or investor-specific investment restrictions

Reporting and Other Disclosure (continued)

– Market Developments (cont.)

- Key person events (expanded application)
- Other events impacting GP/Manager
  - Changes in ownership or control
  - Changes in investment and operations personnel
  - Bankruptcy or insolvency
  - Material adverse change to business, operations, or conditions
  - Legal claims
  - Any amendment to Form ADV

Reporting and Other Disclosure (continued)

- Market Developments (cont.)
  - Events impacting Fund
    - Changes in corporate structure
    - Changes in overall investment objective or strategy
    - Amendments to Fund documents, including valuation procedures
    - Changes in Fund administrator, prime broker/custodian ,or auditor
    - Fund assets become “plan assets” under ERISA
    - Failure to value Fund assets in accordance with valuation procedures
    - Material decline in Fund’s net asset value

Reporting and Other Disclosure (continued)

- Market Developments (cont.)
  - Events impacting Fund (cont.)
    - Investments in "side pocket" or other illiquid investments
    - Use of soft dollars outside the Section 28(e) safe harbor
    - Indemnifications claims
    - Indemnification advances/expense reimbursements
    - Legal claims or governmental proceedings
    - IRS audit
    - Imposition of a withdrawal gate
    - Suspensions of determination of Fund net asset value
    - Suspensions of withdrawal rights or payments of withdrawals proceeds

Reporting and Other Disclosure (continued)

- Market Developments (cont.)
  - Events impacting investor
    - Acts or omissions by GP, Manager or investment personnel causing investor to receive materially adverse publicity
    - Acts or omissions by GP, Manager, or investment personnel otherwise materially adversely affecting investor's reputation

Liquidity

- Accelerated Withdrawal Rights
  - Standard Terms
    - Typically, accelerated withdrawal rights limited to key person events (if any)

Liquidity (continued)

- Accelerated Withdrawal Rights (cont.)
  - Market Developments
    - Accelerated withdrawal rights upon a trigger
      - Violations of applicable law, regulation, or policy
        - » Securities laws or regulations
        - » ERISA or comparable state law
        - » Investor-specific laws, regulations, or policies, including investment restrictions

Liquidity (continued)

- Accelerated Withdrawal Rights (cont.)
  - Market Developments (cont.)
    - Accelerated withdrawal rights upon a trigger (cont.)
      - Amendments of Fund documents
      - Withdrawals by GP, Manager, key persons, and affiliates above a certain threshold
      - Key person events
      - Other events, particularly bad acts

    Note: Typically accompanied by a waiver of applicable notice requirements, withdrawal dates, lock-up periods, fees or penalties, holdbacks, gates, and/or suspensions

Liquidity (continued)

- Frequency of Withdrawals
  - Standard Terms
    - Some funds have hard lock-ups of one year (or longer), sometimes with corresponding management fee options
    - Some funds have soft lock-up features permitting withdrawals during the lock-up period for a fee (typically, 3%-5%), sometimes with corresponding management fee options
    - Some funds have one or more combinations of hard and soft lock-up features, sometimes with corresponding management fee options

Liquidity (continued)

- Frequency of Withdrawals (cont.)
  - Market Developments
    - Fewer hard lock-ups
    - More no lock-ups (with quarterly withdrawal rights)
    - Lower soft lock-up fees (e.g., 2%)

Liquidity (continued)

- Withdrawal Gates and Suspensions
  - Standard Terms
    - Fund-level gates appear at times, generally with no tolling provision
    - Broad authority to suspend withdrawal rights, withdrawal payments, and NAV calculation

Liquidity (continued)

- Withdrawal Gates and Suspensions (cont.)
  - Market Developments
    - Gates
      - More funds adopting a 12 month tolling provision
    - Suspensions
      - Greater specificity of circumstances when suspensions are permitted
      - Notice to all investors of imposition and lifting of suspension

Liquidity (continued)

- Holdbacks
  - Standard Terms
    - Holdbacks often triggered upon withdrawals of 90%-100% of capital
    - Holdback amounts range from 5%-10% of withdrawal proceeds, with payment following the release of the Fund's annual audited financial statements
    - Sometimes, no interest paid on holdback amount

Liquidity (continued)

- Holdbacks (cont.)
  - Market Developments
    - Holdbacks limited to 95% or greater withdrawals or complete withdrawals of capital
    - Holdback amounts limited to 5% of withdrawal proceeds
    - Interest required to be paid on holdback amount

Fees

- Standard Terms
  - Management Fees
    - Monthly or quarterly in advance, typically at an annual rate of between 1%-2%
    - Management fee rate ladders sometimes tied to differing withdrawal rights
  - Incentive Allocations/Fees
    - Annual 15%-20% on net profits (sometimes over a hurdle), subject to a loss carry-forward
    - Incentive allocation/fee rate ladders sometimes tied to differing withdrawal rights

Fees (continued)

- Market Developments
  - Management Fees
    - Investor push for discounts or ladders based on size of subscription (or commitment) or size of overall investment with Manager and its affiliates
  - Incentive Allocations/Fees
    - Increase in commingled funds with no incentive compensation
    - Greater investor interest in bespoke products with no performance compensation or alternative performance compensation arrangements (e.g., multiyear performance periods or partial payment)

Most Favored Nations

- Standard Terms
  - Often subject to size or tiered investment qualifiers
  - Often limited to fee, liquidity, and/or transparency terms
  - Often limited to investors in same Fund
  - Frequently, carve-outs for affiliated investors, seed investors, and other investors based on their legal, regulatory, tax, or other particular status that is not applicable to investor

Most Favored Nations (continued)

- Market Developments
  - Investor push-back against tiered MFN
  - Investor push to cover <u>all</u> terms
  - Investor push to cover side letters with investors in same master-feeder complex as well as parallel trading accounts (i.e., commingled funds, managed accounts, and captive funds with similar strategy)
  - Manager push for no MFN at all

Advisory Committee

- Standard Terms
  - Market practice for private equity and venture capital funds
    - Appointed by the general partner
    - Typically largest investors, sometimes strategic investors
    - Approve transactions involving conflicts of interest and evaluate valuation policies
  - Rarely used in hedge funds
    - Comprised of independent person(s), not investors
    - Limited to approving conflict of interest transactions

Advisory Committee (continued)

– Market Developments

- Possible expansion of Advisory Committee membership to include investors, particularly strategic investors
- Possible expanded role of Advisory Committees
  - Advise on conflicts of interests
  - Consult on investment strategy and performance
  - Consult on valuation matters, particularly illiquid assets
  - Consent to affiliated transactions when investor consent is required
  - Consult on material changes and appointment/replacement of Fund service providers

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Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

Investor Relations and Finder Activity: When is it Brokerage?

Robert C. Mendelson

May 2, 2013

www.morganlewis.com

Finders and Brokers

- The SEC and SEC staff have long viewed receipt of transaction-based compensation as a hallmark of being a broker.
- David Blass of Trading and Markets offered this cogent reason:
  - "The broker regulatory structure is built, at least in large part, around managing the conflict of interest arising from a broker acting as a securities salesman, as compared to an investment adviser which traditionally acts as a fiduciary and which should not have that same type of conflict of interest."
    [Speech available at
    http://www.sec.gov/news/speech/2013/spch040513dwg.htm]

Other Factors

- Factors specifically related to private funds:
  - Marketing securities (shares or interests in a private fund) to investors,
  - soliciting or negotiating securities transactions, or
  - handling customer funds and securities.
- There are a number of no-action letters that came out at the time of the statutory requirements for registration of government securities broker-dealers that analyze a number of other factors.
- The key is do you have or seek a customer clientele and get paid transaction based compensation for doing so.

Ranieri Partners, Phillips and Stephens

- Stephens solicited investors as a hired consultant for Ranieri Partners and was paid fees by the firm, but never registered as a broker.
  – Fees were a % of investment – classic transaction based compensation
- Phillips, a senior managing director who headed up capital raising efforts for Ranieri Partners, was responsible for overseeing Stephens' activities as a purported "finder."
  – Finder would merely make initial introductions to potential investors.

So What Did Stephens Do?

- But Stephens' role went far beyond that of a finder.
  - Stephens engaged in the business of effecting transactions in securities in several ways despite not being registered as a broker or affiliated with a registered broker-dealer. His solicitation efforts included:
    - *sent private placement memoranda, subscription documents, and due diligence materials to potential investors,*
    - *urged at least one investor to consider adjusting portfolio allocations to accommodate an investment with Ranieri Partners,*
    - *provided potential investors with his analysis of the strategy and performance track record for Ranieri Partners' funds,*
    - *and also provided confidential information identifying other investors and their capital commitments.*

What Didn’t Phillips and Ranieri Partners Do?

- Phillips and Ranieri Partners
  - Phillips aided and abetted Stephens’ violations by providing Stephens with key fund documents and information while ignoring red flags.
    - *Indicating that Stephens had gone well beyond the limited role of a finder.*
    - *Stephens was actively soliciting investments.*
  - Ranieri Partners put no controls in place and took steps antithetical to any minimal controls to assist Stephens’ solictitation efforts.

What Could Have Been Done?

- A flat fee or monthly stipend that had no success element to it.
- Not provide Stephens with materials to send to potential investors but send these out from the Firm.
- Have his consulting contract delineate what a finder is permitted to do.
  - Introduce potential investors to firm personnel.
  - Attend meetings with potential investors and firm personnel.
  - Finder not to prepare separate analyses.
  - Not provide Finder with performance track record information.
  - Finder not to make recommendations as to buying or selling securities.

Ranieri Partners, Phillips and Stephens

- SEC Press Release
  – http://www.sec.gov/news/press/2013/2013-36.htm
- SEC Order Ranieri Partners and Phillips:
  – http://www.sec.gov/litigation/admin/2013/34-69091.pdf
- SEC Order Stephens:
  – http://www.sec.gov/litigation/admin/2013/34-69090.pdf

SEC Charges Private Equity Firm, Former Executive, and Consultant for Improperly Soliciting Investments

FOR IMMEDIATE RELEASE
2013-36

Washington, D.C., March 11, 2013 — The Securities and Exchange Commission today announced charges against New York-based private equity firm Ranieri Partners, a former senior executive, and an unregistered broker who violated securities laws when soliciting more than $500 million in capital commitments for private funds managed by the firm.

Additional Materials

- SEC Order: William M. Stephens
- SEC Order: Ranieri Partners LLC and Donald W. Phillips

The federal securities laws require that an individual who solicits investments in return for transaction-based compensation be registered as a broker. An SEC investigation found that William M. Stephens of Hinsdale, Ill., solicited investors as a hired consultant for Ranieri Partners and was paid fees by the firm, but never registered as a broker. Stephens' longtime friend Donald W. Phillips, a senior managing director who headed up capital raising efforts for Ranieri Partners, was responsible for overseeing Stephens' activities as a purported "finder" who would merely make initial introductions to potential investors. But Stephens' role went far beyond that of a finder. He consistently communicated with prospective investors and their advisors and provided them with key investment documentation that he received from Ranieri Partners.

Ranieri Partners, Phillips, and Stephens agreed to settle the SEC's charges.

"Registered brokers are subject to SEC oversight and examinations in order to monitor their conduct and protect the interests of investors," said Merri Jo Gillette, Director of the SEC's Chicago Regional Office. "Investors in Ranieri Partners' funds were denied these protections because Stephens acted outside the boundaries of the law, and Phillips and the firm ignored the essence of his activities."

According to the SEC's orders instituting settled administrative and cease-and-desist proceedings, Stephens engaged in the business of effecting transactions in securities in several ways despite not being registered as a broker or affiliated with a registered broker-dealer. Stephens sent private placement memoranda, subscription documents, and due diligence materials to potential investors, and urged at least one investor to consider adjusting portfolio allocations to accommodate an investment with Ranieri

Partners. Stephens provided potential investors with his analysis of the strategy and performance track record for Ranieri Partners' funds, and also provided confidential information identifying other investors and their capital commitments. The SEC charged Stephens with violating Section 15 (a) of the Securities Exchange Act, which requires people acting as brokers to be registered with the SEC.

The SEC's order against Phillips and Ranieri Partners found that Phillips, who lives in Barrington, Ill., aided and abetted Stephens' violations by providing Stephens with key fund documents and information while ignoring red flags indicating that Stephens had gone well beyond the limited role of a finder and was actively soliciting investments. The order found that Ranieri Partners caused Stephens' violations.

In settling the SEC's charges, Ranieri Partners agreed to pay a penalty of $375,000, Phillips agreed to pay a penalty of $75,000, and Stephens agreed to be barred from the securities industry. The SEC's orders require each of them to cease-and-desist from further violations of Section 15(a). The SEC also suspended Phillips from acting in a supervisory capacity at an investment adviser or broker-dealer for nine months. Ranieri Partners, Phillips and Stephens consented to the entry of the SEC's orders without admitting or denying the findings.

The SEC's investigation was conducted by Jason Howard, Steven L. Klawans and John J. Sikora, Jr., in the Chicago Regional Office with assistance from examiners John T. Brodersen and Eric P. Donofrio.

# # #

http://www.sec.gov/news/press/2013/2013-36.htm

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69091 / March 8, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3563 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15234

In the Matter of **Ranieri Partners LLC and Donald W. Phillips,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Donald W. Phillips ("Phillips" or "Respondent Phillips"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and that cease-and-desist proceedings be, and hereby are, instituted against Ranieri Partners LLC ("Ranieri Partners" or "Respondent Ranieri Partners") pursuant to Section 21C of the Exchange Act.

II.

In anticipation of the institution of these proceedings, the Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and the Respondents' Offers, the Commission finds[1] that:

Summary

From February 2008 through March 2011, William M. Stephens ("Stephens") operated as an unregistered broker in violation of Section 15(a) of the Exchange Act. While working as an independent consultant for Ranieri Partners, Stephens actively solicited investors on behalf of private funds managed by Ranieri Partners' affiliates and, in return, received transaction-based compensation totaling approximately $2.4 million. Stephens' solicitation efforts included: (1) sending private placement memoranda, subscription documents, and due diligence materials to potential investors; (2) urging at least one investor to consider adjusting its portfolio allocations to accommodate an investment with Ranieri Partners; (3) providing potential investors with his analysis of Ranieri Partners' funds' strategy and performance track record; and (4) providing potential investors with confidential information relating to the identity of other investors and their capital commitments. By these actions, Stephens engaged in the business of effecting transactions in securities without first being registered as a broker or dealer or associated with a registered broker or dealer. Ranieri Partners and Donald W. Phillips ("Phillips"), its then Senior Managing Partner, provided Stephens with key documents and information related to Ranieri Partners' private equity funds and did not take adequate steps to prevent Stephens from having substantive contacts with potential investors.

Respondents

1. Ranieri Partners is a holding company located in New York, New York. It controls Selene Investment Partners LLC and Selene Investment Partners II LLC, which managed the investments of Selene Residential Mortgage Opportunity Fund L.P. ("Selene I") and Selene Residential Mortgage Opportunity Fund II L.P. ("Selene II") (collectively the "Selene Funds"). On March 26, 2012, Ranieri Residential Investment Advisors, LLC ("RRIA"), another entity controlled by Ranieri Partners, registered with the Commission as an investment adviser and now is the investment adviser to the Selene Funds.

2. Donald W. Phillips, age 63, resides in Barrington, Illinois. Phillips was a Senior Managing Partner of Ranieri Partners before resigning in December 2012. At the time of the conduct at issue, Phillips also was a managing member of a Chicago-based registered investment adviser.

Other Relevant Individuals

3. William M. Stephens, age 60, resides in Hinsdale, Illinois. From 1986 to 1998, Stephens was an asset manager for various public and private pension funds. From 1998 to 2000, Stephens was the Chief Investment Strategist at a San Francisco-based registered investment

[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

adviser. In June 2000, the Commission instituted public administrative and cease-and-desist proceedings against Stephens and, in November 2002, the Commission entered an order, based on an offer of settlement by Stephens, finding that Stephens violated certain provisions of the federal securities laws in connection with the investment of pension fund assets. Stephens agreed to the entry of an order requiring him to cease and desist from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Sections 206(1) and 206(2) of the Advisers Act. The Commission also barred Stephens from association with any investment adviser, with the right to reapply after two years, and imposed a $25,000 civil penalty. Stephens never reapplied for permission to become associated with an investment adviser. Since 2002, Stephens has not been registered with the Commission in any capacity, including as a broker or dealer.

Background

4. In January 2008, Ranieri Partners established the Selene I private investment fund. Selene I's investment strategy was to use investor capital to purchase underperforming or nonperforming residential mortgages, or loan portfolios, at a discount, rehabilitate the mortgages, and then resell them to traditional mortgage companies at a premium. The Private Placement Memorandum ("PPM") for Selene I also permitted the fund to purchase mortgage-backed securities. In 2010, Ranieri Partners formed Selene II. Selene II's investment strategy focused on generating returns from the rehabilitation of distressed residential mortgages.

5. Phillips, a Senior Managing Partner of Ranieri Partners, was in charge of raising capital for the Selene Funds. Phillips was a long-time friend of Stephens. In February 2008, Phillips caused an affiliate of Ranieri Partners to retain Stephens as an independent consultant to find potential investors for Selene I. At the time, Phillips was generally aware of Stephens' prior disciplinary history with the Commission. In 2010, Phillips again caused an affiliate of Ranieri Partners to retain Stephens to find potential investors, this time for Selene II.[2]

6. Ranieri Partners agreed to pay Stephens a fee equal to 1% of all capital commitments made to the Selene Funds by investors introduced by Stephens.

7. Phillips was responsible for coordinating the activities of Stephens and others engaged by Ranieri Partners to find potential investors for the Selene Funds. According to Phillips, he informed Stephens that Stephens' activities on behalf of Ranieri Partners were limited to contacting potential investors to arrange meetings for the principals of Ranieri Partners and that he specifically informed Stephens that he was not permitted to provide PPMs directly to potential investors. Ranieri Partners controlled the distribution of PPMs for the Selene Funds. According to Phillips, he also informed Stephens that Stephens was not permitted to contact investors directly to discuss his views of the merits and strategies of the Selene Funds.

8. Phillips and other Ranieri Partners personnel provided Stephens with materials relating to the Selene Funds. On February 29, 2008, Phillips sent Stephens several copies of a Selene I Executive Summary, which summarized the fund's investment strategy and provided

[2] In both instances, the terms of Stephens' engagement were reflected in consulting services agreements prepared by outside counsel to Ranieri Partners.

Ranieri Partners' view of the distressed mortgage market and the firm's competitive advantages in the distressed real estate space. On March 1, 2008, Ranieri Partners personnel provided Stephens with a copy of the Selene I PPM and, subsequently, provided Stephens with supplemental PPMs, subscription documents, and presentation materials. Ranieri Partners personnel also provided Stephens with marketing materials for Selene II, including an Executive Summary and PPM, as well as Ranieri Partners' overall business plan.

<u>Stephens Solicited Investors for Selene I</u>

9. Beginning in February 2008, Stephens contacted certain of his acquaintances and former colleagues in the pension fund investment community concerning a possible investment in Selene I.

10. In February 2008, Stephens contacted a former colleague who was the Director of Retirement Investments (hereinafter referred to as "Executive X") for a private corporation (hereinafter referred to as "Company X"). On February 26, 2008, Stephens contacted Executive X to set up a meeting among himself, Executive X, and Phillips. On February 28th, Stephens and Phillips met with Executive X. During the meeting, Phillips described a possible investment in Selene I. After the meeting, Stephens continued to communicate with Executive X directly via email. On March 4th, Stephens provided Executive X with details about Selene I's investment strategy. On April 29th, Stephens emailed Executive X to inform her that he provided due diligence materials regarding Selene I to a consultant that advises Company X on money manager selection and retention. In the same email, Stephens described the Selene I investment as "a rare opportunity to earn above market returns," and encouraged Executive X to consider adjusting Company X's asset allocation plan to take advantage of the Selene I opportunity. Also, Stephens traveled to various cities on four separate occasions in 2008 to meet with Company X's consultant, who was a friend and former consultant to pension funds managed by Stephens. Stephens continued to call upon Company X for an investment in Selene I until at least April 2009, when he again flew to the company's headquarters to meet with Executive X. Despite Stephens' efforts, Company X did not invest in Selene I.

11. In March 2008, Stephens contacted the Chief Investment Officer ("CIO") of an endowment fund of a Midwestern university ("Endowment X") regarding a possible investment in Selene I. Stephens had a close connection to the CIO, who worked for Stephens in the late 1990s when Stephens was the CIO of a large corporate pension fund. Stephens set up a meeting with the CIO to discuss Selene I. At the meeting, Stephens and Phillips met with the CIO and other members of his staff. During the meeting, Phillips made a presentation concerning a possible investment in Selene I. Shortly after the meeting, Stephens sent a copy of the Selene I PPM and other subscription materials to an Endowment X staff member. On April 21st, Stephens sent an email to the same staff member that contained a list of current and prospective investors for Selene I. In the email, Stephens listed the expected dates and amounts of the investors' respective capital commitments and then explained that there was a cap on the amount of investments that would be allowed in Selene I. On April 23rd, Stephens sent another email to the staff attaching additional due diligence materials on Selene I. On June 30, 2008, Endowment X committed $65 million in capital to Selene I. Pursuant to his agreement with Ranieri Partners, Stephens was to be paid $650,000 on the investment.

12. In April 2008, Stephens used a subagent to reach out to the retirement system for a Southern state ("State Retirement System X") concerning a possible investment in Selene I. Stephens' subagent arranged a meeting for Phillips to meet with the CIO of State Retirement System X and his staff. Stephens' subagent accompanied Phillips to the meeting, which took place in April 2008. On June 30, 2008, State Retirement System X invested $200 million in Selene I. As a result, Ranieri Partners owed Stephens a fee equal to 1% ($2 million) of the total capital commitment. Pursuant to a side agreement between Stephens and his subagent, 80% of Stephens' fee was to be paid to the subagent.

Stephens Solicited Investors for Selene II

13. Between August 2010 and March 2011, Stephens contacted Executive X about a possible investment by Company X in Selene II. Stephens traveled to Company X's headquarters to discuss Selene II with Executive X and then traveled to meet with Company X's consultant. Stephens also drafted correspondence, for Phillips' signature, that addressed key questions about the potential investment that were raised by Executive X. Stephens continued to contact Executive X until at least March 2, 2011. Once again, despite Stephens' efforts, Company X did not invest in Selene II.

14. In August 2010, Stephens contacted the CIO of Endowment X about a possible investment in Selene II. In an email dated August 4th, Stephens told the CIO and another staff member of Endowment X that the "returns to [Selene I] have been strong and the outlook for [Selene II] looks real positive with Ranieri Partners taking on the role of market leader in this space." In the same email, Stephens told the CIO that Endowment X would pay a lower management fee if it made a commitment before the first closing date for the fund. Stephens also traveled on two occasions to discuss Selene II with the CIO. On October 15th, Endowment X invested $30 million in Selene II. Pursuant to Stephens' agreement with Ranieri Partners, he was to receive 1% of the funds invested by Endowment X, or approximately $300,000.

15. In 2009, Stephens contacted State Retirement System X regarding an investment in Selene II. Stephens and his subagent traveled to meet with the CIO of State Retirement System X on two occasions in 2009. In addition, after State Retirement System X invested in Selene I, its investment office staff stayed in direct contact with Ranieri Partners. After these meetings and contacts, State Retirement System X invested $150 million in Selene II and an additional $124 million in a special purpose investment vehicle established by Ranieri Partners specifically for State Retirement System X. Pursuant to a new agreement negotiated between Stephens and Phillips, Ranieri Partners was to pay Stephens a fee equal to 0.3% of State Retirement System X's capital commitments, or approximately $822,000.

16. In total, investors introduced to Ranieri Partners by Stephens and/or his subagent committed $569 million to funds managed by Ranieri Partners, earning Stephens $3.772 million in fees. Ranieri Partners paid Stephens $2.4 million of the fees he earned. Ranieri Partners also reimbursed Stephens for travel and entertainment expenses he incurred in connection with raising capital for the Selene Funds. The expenses claimed by Stephens include trips to meet potential investors that Stephens took both with and without Phillips or any other Ranieri Partners personnel.

Stephens' expense reports show that he met with representatives of Company X, Endowment X, and State Retirement System X several times after initially introducing them to Ranieri Partners.

17. Stephens was not registered as a broker or dealer or associated with a registered broker or dealer at any time while he was soliciting investors on behalf of Ranieri Partners.

18. Ranieri Partners failed to adequately oversee Stephens' activities. Although Stephens was not permitted to send documents like PPMs and subscription agreements to potential investors, he was able to obtain such documents from Ranieri Partners, as Ranieri Partners failed to limit Stephens' access to key documents. Stephens, in turn, sent such documents to potential investors. Ranieri Partners also received Stephens' requests for expense reimbursements, which reflected Stephens' extensive contact with potential investors. Yet Ranieri Partners did nothing to monitor or limit Stephens' contact with investors.

19. Since the conduct in question, Ranieri Partners has modified its policies and procedures to provide that it would not retain a third party, including a finder or marketer, that was not a broker or dealer or registered representative of a broker or dealer to market or place any security or investment in any security of any affiliate of Ranieri Partners. Those revised policies and enhanced procedures were implemented in 2011 and were fully in place during 2012. The Commission considered the remedial efforts undertaken by Ranieri Partners in determining to accept Ranieri Partners' Offer.

20. Phillips assisted Stephens' in his solicitation efforts by providing Stephens with key fund documents and information. Phillips also failed to limit Stephens' activities despite knowing that Stephens was supposed to play a limited role in introducing potential investors. Further, Phillips eventually became aware that Stephens was having substantive communications with potential investors, yet he still failed to do anything to curb Stephens' activities. Phillips did little to monitor Stephens' activities other than hold a weekly meeting at which Stephens and others discussed their progress in raising capital for the Selene Funds.

Violations

21. As a result of the conduct described above, Ranieri Partners caused Stephens' violations of 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.

22. As a result of the conduct described above, Phillips willfully aided and abetted and caused Stephens' violations of Section 15(a) of the Exchange Act.

Undertakings

23. Phillips undertakes to provide to the Commission, within 15 days after the end of the nine-month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV, below.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that**:**

A. Ranieri Partners

1. Respondent Ranieri Partners shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

2. Respondent Ranieri Partners shall, within 30 days of the entry of this Order, pay a civil money penalty of $375,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

   (1) Respondent Ranieri Partners may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

   (2) Respondent Ranieri Partners may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand delivered or mailed to:

   Enterprise Services Center
   Accounts Receivable Branch
   HQ Bldg., Room 181, AMZ-341
   6500 South MacArthur Boulevard
   Oklahoma City, OK 73169

   Payments by check or money order must be accompanied by a cover letter identifying Ranieri Partners as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Timothy L. Warren, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604.

B. Phillips

1. Respondent Phillips shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

2. Respondent Phillips be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer,

municipal adviser, transfer agent, or nationally recognized statistical rating organization for a period of nine (9) months, effective on the second Monday following the entry of this Order.

3. Respondent Phillips shall, within 30 days of the entry of this Order, pay a civil money penalty of $75,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

   (1) Respondent Phillips may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

   (2) Respondent Phillips may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand delivered or mailed to:

   Enterprise Services Center
   Accounts Receivable Branch
   HQ Bldg., Room 181, AMZ-341
   6500 South MacArthur Boulevard
   Oklahoma City, OK 73169

   Payments by check or money order must be accompanied by a cover letter identifying Donald W. Phillips as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Timothy L. Warren, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604.

4. Respondent Phillips shall comply with the undertakings enumerated in Section III, paragraph 23, above.

By the Commission.

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69090 / March 8, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30417 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15233

In the Matter of **William M. Stephens,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against William M. Stephens ("Stephens" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and the Respondent's Offer, the Commission finds[1] that:

Summary

From February 2008 through March 2011, William M. Stephens operated as an unregistered broker in violation of Section 15(a) of the Exchange Act. While working as an independent consultant for Ranieri Partners LLC, Stephens actively solicited investors on behalf of private funds managed by Ranieri Partners' affiliates and, in return, received transaction-based compensation totaling approximately $2.4 million. Stephens' solicitation efforts included: (1) sending private placement memoranda, subscription documents, and due diligence materials to potential investors; (2) urging at least one investor to consider adjusting its portfolio allocations to accommodate an investment with Ranieri Partners; (3) providing potential investors with his analysis of Ranieri Partners' funds' strategy and performance track record; and (4) providing potential investors with confidential information relating to the identity of other investors and their capital commitments. By these actions, Stephens engaged in the business of effecting transactions in securities without first being registered as a broker or dealer or associated with a registered broker or dealer. Ranieri Partners and Donald W. Phillips ("Phillips"), its then Senior Managing Partner, provided Stephens with key documents and information related to Ranieri Partners' private equity funds and did not take adequate steps to prevent Stephens from having substantive contacts with potential investors.

Respondent

1. William M. Stephens, age 60, resides in Hinsdale, Illinois. From 1986 to 1998, Stephens was an asset manager for various public and private pension funds. From 1998 to 2000, Stephens was the Chief Investment Strategist at a San Francisco-based registered investment adviser. In June 2000, the Commission instituted public administrative and cease-and-desist proceedings against Stephens and, in November 2002, the Commission entered an order, based on an offer of settlement by Stephens, finding that Stephens violated certain provisions of the federal securities laws in connection with the investment of pension fund assets. Stephens agreed to the entry of an order requiring him to cease and desist from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940. The Commission also barred Stephens from association with any investment adviser, with the right to reapply after two years, and imposed a $25,000 civil penalty. Stephens never reapplied for permission to become associated with an investment adviser. Since 2002, Stephens has not been registered with the Commission in any capacity, including as a broker or dealer.

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Other Relevant Entities and Individuals

2. Ranieri Partners is a holding company located in New York, New York. It controls Selene Investment Partners LLC and Selene Investment Partners II LLC, which managed the investments of Selene Residential Mortgage Opportunity Fund L.P. ("Selene I") and Selene Residential Mortgage Opportunity Fund II L.P. ("Selene II") (collectively the "Selene Funds"). On March 26, 2012, Ranieri Residential Investment Advisors, LLC ("RRIA"), another entity controlled by Ranieri Partners, registered with the Commission as an investment adviser and now is the investment adviser to the Selene Funds.

3. Donald W. Phillips, age 63, resides in Barrington, Illinois. Phillips was a Senior Managing Partner of Ranieri Partners before resigning in December 2012. At the time of the conduct at issue, Phillips also was a managing member of a Chicago-based registered investment adviser.

Background

4. In January 2008, Ranieri Partners established the Selene I private investment fund. Selene I's investment strategy was to use investor capital to purchase underperforming or nonperforming residential mortgages, or loan portfolios, at a discount, rehabilitate the mortgages, and then resell them to traditional mortgage companies at a premium. The Private Placement Memorandum ("PPM") for Selene I also permitted the fund to purchase mortgage-backed securities. In 2010, Ranieri Partners formed Selene II. Selene II's investment strategy focused on generating returns from the rehabilitation of distressed residential mortgages.

5. Phillips, a Senior Managing Partner of Ranieri Partners, was in charge of raising capital for the Selene Funds. Phillips was a long-time friend of Stephens. In February 2008, Phillips caused an affiliate of Ranieri Partners to retain Stephens as an independent consultant to find potential investors for Selene I. At the time, Phillips was generally aware of Stephens' prior disciplinary history with the Commission. In 2010, Phillips again caused an affiliate of Ranieri Partners to retain Stephens to find potential investors, this time for Selene II.[2]

6. Ranieri Partners agreed to pay Stephens a fee equal to 1% of all capital commitments made to the Selene Funds by investors introduced by Stephens.

7. Phillips was responsible for coordinating the activities of Stephens and others engaged by Ranieri Partners to find potential investors for the Selene Funds. According to Phillips, he informed Stephens that Stephens' activities on behalf of Ranieri Partners were limited to contacting potential investors to arrange meetings for the principals of Ranieri Partners and that he specifically informed Stephens that he was not permitted to provide PPMs directly to potential investors. Ranieri Partners controlled the distribution of PPMs for the Selene Funds. According to Phillips, he also informed Stephens that Stephens was not permitted to contact investors directly to discuss his views of the merits and strategies of the Selene Funds.

[2] In both instances, the terms of Stephens' engagement were reflected in consulting services agreements prepared by outside counsel to Ranieri Partners.

8. Phillips and other Ranieri Partners personnel provided Stephens with materials relating to the Selene Funds. On February 29, 2008, Phillips sent Stephens several copies of a Selene I Executive Summary, which summarized the fund's investment strategy and provided Ranieri Partners' view of the distressed mortgage market and the firm's competitive advantages in the distressed real estate space. On March 1, 2008, Ranieri Partners personnel provided Stephens with a copy of the Selene I PPM and, subsequently, provided Stephens with supplemental PPMs, subscription documents, and presentation materials. Ranieri Partners personnel also provided Stephens with marketing materials for Selene II, including an Executive Summary and PPM, as well as Ranieri Partners' overall business plan.

Stephens Solicited Investors for Selene I

9. Beginning in February 2008, Stephens contacted certain of his acquaintances and former colleagues in the pension fund investment community concerning a possible investment in Selene I.

10. In February 2008, Stephens contacted a former colleague who was the Director of Retirement Investments (hereinafter referred to as "Executive X") for a private corporation (hereinafter referred to as "Company X"). On February 26, 2008, Stephens contacted Executive X to set up a meeting among himself, Executive X, and Phillips. On February 28th, Stephens and Phillips met with Executive X. During the meeting, Phillips described a possible investment in Selene I. After the meeting, Stephens continued to communicate with Executive X directly via email. On March 4th, Stephens provided Executive X with details about Selene I's investment strategy. On April 29th, Stephens emailed Executive X to inform her that he provided due diligence materials regarding Selene I to a consultant that advises Company X on money manager selection and retention. In the same email, Stephens described the Selene I investment as "a rare opportunity to earn above market returns," and encouraged Executive X to consider adjusting Company X's asset allocation plan to take advantage of the Selene I opportunity. Also, Stephens traveled to various cities on four separate occasions in 2008 to meet with Company X's consultant, who was a friend and former consultant to pension funds managed by Stephens. Stephens continued to call upon Company X for an investment in Selene I until at least April 2009, when he again flew to the company's headquarters to meet with Executive X. Despite Stephens' efforts, Company X did not invest in Selene I.

11. In March 2008, Stephens contacted the Chief Investment Officer ("CIO") of an endowment fund of a Midwestern university ("Endowment X") regarding a possible investment in Selene I. Stephens had a close connection to the CIO, who worked for Stephens in the late 1990s when Stephens was the CIO of a large corporate pension fund. Stephens set up a meeting with the CIO to discuss Selene I. At the meeting, Stephens and Phillips met with the CIO and other members of his staff. During the meeting, Phillips made a presentation concerning a possible investment in Selene I. Shortly after the meeting, Stephens sent a copy of the Selene I PPM and other subscription materials to an Endowment X staff member. On April 21st, Stephens sent an email to the same staff member that contained a list of current and prospective investors for Selene I. In the email, Stephens listed the expected dates and amounts of the investors' respective capital commitments and then explained that there was a cap on the amount of investments that would be allowed in Selene I. On April 23rd, Stephens sent another email to the staff attaching

additional due diligence materials on Selene I. On June 30, 2008, Endowment X committed $65 million in capital to Selene I. Pursuant to his agreement with Ranieri Partners, Stephens was to be paid $650,000 on the investment.

12. In April 2008, Stephens used a subagent to reach out to the retirement system for a Southern state ("State Retirement System X") concerning a possible investment in Selene I. Stephens' subagent arranged a meeting for Phillips to meet with the CIO of State Retirement System X and his staff. Stephens' subagent accompanied Phillips to the meeting, which took place in April 2008. On June 30, 2008, State Retirement System X invested $200 million in Selene I. As a result, Ranieri Partners owed Stephens a fee equal to 1% ($2 million) of the total capital commitment. Pursuant to a side agreement between Stephens and his subagent, 80% of Stephens' fee was to be paid to the subagent.

Stephens Solicited Investors for Selene II

13. Between August 2010 and March 2011, Stephens contacted Executive X about a possible investment by Company X in Selene II. Stephens traveled to Company X's headquarters to discuss Selene II with Executive X and then traveled to meet with Company X's consultant. Stephens also drafted correspondence, for Phillips' signature, that addressed key questions about the potential investment that were raised by Executive X. Stephens continued to contact Executive X until at least March 2, 2011. Once again, despite Stephens' efforts, Company X did not invest in Selene II.

14. In August 2010, Stephens contacted the CIO of Endowment X about a possible investment in Selene II. In an email dated August 4th, Stephens told the CIO and another staff member of Endowment X that the "returns to [Selene I] have been strong and the outlook for [Selene II] looks real positive with Ranieri Partners taking on the role of market leader in this space." In the same email, Stephens told the CIO that Endowment X would pay a lower management fee if it made a commitment before the first closing date for the fund. Stephens also traveled on two occasions to discuss Selene II with the CIO. On October 15th, Endowment X invested $30 million in Selene II. Pursuant to Stephens' agreement with Ranieri Partners, he was to receive 1% of the funds invested by Endowment X, or approximately $300,000.

15. In 2009, Stephens' subagent contacted State Retirement System X regarding an investment in Selene II. Stephens and his subagent traveled to meet with the CIO of State Retirement System X on two occasions in 2009. In addition, after State Retirement System X invested in Selene I, its investment office staff stayed in direct contact with Ranieri Partners. After these meetings and contacts, State Retirement System X invested $150 million in Selene II and an additional $124 million in a special purpose investment vehicle established by Ranieri Partners specifically for State Retirement System X. Pursuant to a new agreement negotiated between Stephens and Phillips, Ranieri Partners was to pay Stephens a fee equal to 0.3% of State Retirement System X's capital commitments, or approximately $822,000.

16. In total, investors introduced to Ranieri Partners by Stephens and/or his subagent committed $569 million to funds managed by Ranieri Partners, earning Stephens $3.772 million in fees. Ranieri Partners paid Stephens $2.4 million of the fees he earned. Ranieri Partners also

reimbursed Stephens for travel and entertainment expenses he incurred in connection with raising capital for the Selene Funds. The expenses claimed by Stephens include trips to meet potential investors that Stephens took both with and without Phillips or any other Ranieri Partners personnel. Stephens' expense reports show that he met with representatives of Company X, Endowment X, and State Retirement System X several times after initially introducing them to Ranieri Partners.

17. Stephens was not registered as a broker or dealer or associated with a registered broker or dealer at any time while he was soliciting investors on behalf of Ranieri Partners.

Violations

18. As a result of the conduct described above, Stephens 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.

Disgorgement and Civil Penalties

19. Respondent has submitted a sworn Statement of Financial Condition dated January 28, 2013 and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest or a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that**:**

A. Respondent Stephens shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Stephens be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay disgorgement of $2,418,379.20 and prejudgment interest of $410,248.75, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated January 28, 2013 and other documents submitted to the Commission. Further, based upon Respondent's sworn representations in his Statement of Financial Condition dated January 28, 2013 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement, pre-judgment interest, and a civil penalty. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement, interest, or penalties should not be ordered; (3) contest the amount of disgorgement, interest, or penalties to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

Morgan Lewis

Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

Swaps Regulation is Here

Michael M. Philipp
Will Iwaschuk
Michael A. Piracci
Thomas V. D'Ambrosio

May 2, 2013

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CFTC and Congress

- Congress created the Commodity Futures Trading Commission (CFTC) in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States.
- The CFTC's mandate has been renewed and expanded several times since then, most recently by Dodd Frank, to cover swaps.
- The CFTC is <u>not</u> a permanent agency (unlike the SEC).
- The CFTC must be reauthorized by Congress every five years.
- It is up for reauthorization this year.
- The CFTC is under the jurisdiction of the House and Senate Agricultural Committees.

Commissioners

- Consists of Five Commissioners (Gary Gensler, Chairman (D), Jill Sommers (R), Bart Chilton (D), Scott O'Malia (R), Mark Wetjen (D))
- President appoints/Senate confirms
- Staggered Five Year Terms
- No more than three Commissioners may be from the same political party.
- President designates one Commissioner to serve as Chairman with the advice and consent of the Senate.
- Chairman Gensler's term expired 4/13/12—permitted to stay on until end of 2013, but he indicated that he may leave earlier.

Commissioners (continued)

- Chilton's term expired 4/13/13—permitted to stay on until the end of 2014.
- Jill Sommers has announced her resignation (effective date unknown).
- Until the President designates a new Commissioner to serve as Chair, the remaining Commissioners appoint an acting Chair—customarily, but not necessarily, the senior Commissioner from the governing party—in this case, potentially Chilton.

Power of the Chairman

- Office of the Chairman oversees the Commissioner's Divisions
  - Division of Clearing and Risk
  - Division of Market Oversight
  - Division of Swap Dealer and Intermediary Oversight
  - Division of Enforcement
- Division Directors report to the Chairman, thus the Chairman controls the CFTC's agenda, and effectively controls the rulemaking and no-action process.

CFTC Dodd-Frank Implementation

- July 21, 2010— President Obama signs the Dodd-Frank Act, amending the Commodity Exchange Act to establish a comprehensive new regulatory framework for swaps and security-based swaps.
- The CFTC identifies 38 swap rulemaking areas including SD and MSP registration, Clearing, Trading, Data Reporting, Product Definitions, Enforcement, Position Limits, Cross-Border Issues, and Incorporation of Swaps into CFTC regulatory framework.
- The CFTC has adopted 43 final rules and 11 final orders.
- The CFTC has issued 80 no-action and staff letters since July 2, 2012 to April 9, 2013.
- The CFTC has issued 7 FAQs.

What We Know (since last year's conference)

- Swap Definition
- SD and MSP Definitions
- Status of FX
- IRS and CDS clearing
- Reporting requirements
- Clearing and reporting exemptions for affiliated entities
- Recordkeeping requirements

Recent and Upcoming Title VII Dates for Hedge Funds

- **March 11, 2013** — Mandatory clearing for Category 1 entities for IRS and CDS, other than for swaps on iTraxx indices
- **April 10, 2013** — Commence reporting IRS and CDS under Part 43 and Part 45 and compliance date for recordkeeping
- **April 26, 2013** — Mandatory clearing for Category 1 entities for swaps on iTraxx indices
- **May 1, 2013** — External business conduct rules compliance deadline (ISDA August Protocol)
- **May 29, 2013** — Commence reporting for equity, foreign exchange and other commodity swaps under Part 43 and Part 45 (12:01 a.m. Eastern time)
- **June 10, 2013** — Mandatory clearing for IRS and CDS for Category 2 entities, other than swaps on iTraxx indices
- **June 29, 2013** — Deadline for SDR reporting of equity, forex and other commodity swaps between April 10, 2013 and May 29, 2013
- **July 1, 2013** — Swap trader relationship documents and other rules compliance deadline (ISDA March Protocol)
- **July 12, 2013** — Scheduled expiration of CFTC's Exemptive Order on Cross-Border Swaps
- **July 25, 2013** — Mandatory clearing for Category 2 entities for swaps on iTraxx indices
- **Sept 30, 2013** — Deadline for SDR reporting of historical swaps under Part 46, including swaps executed before April 10, 2013

Category 1 entities include "active funds," which are private funds, other than third-party subaccounts, that execute 200 or more swaps per month on a monthly average over the preceding 12 months, beginning November 1, 2012.

Category 2 entities include commodity pools, private funds, other than active funds, and persons predominantly engaged in banking or financial activities, other than third-party subaccounts and ERISA plans.

Third-party subaccounts are client accounts managed by an unaffiliated and independent investment manager that is responsible for the documentation necessary for clearing.

Reporting deadlines on the timeline reflect the relief provided by the CFTC staff on April 9, 2013 that may be available to the fund. That relief is subject to important conditions, including the requirement to "backload" swaps information to the SDR.

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What is Ahead

- SEF market structure
- Trading requirement
- What products other than IRS and CDS will be subject to the clearing/trading requirement
- Federal position limits and position aggregation rules
- Margin for uncleared swaps
- Definition of "US Person" for SDs and MSPs
- DCM Core Principle 9 (EFPs and EFSs)
- Revisions To Appendix A of Part 4 for Fund of Funds

CPO/CTA Registration

- The Commodity Exchange Act requires the “operator” (*i.e.*, sponsor/adviser) of a commodity pool to register as a CPO.
  - CFTC registration applies to the CPO, rather than the fund itself.
  - An exemption is available for hedge funds if trading in commodity interests is *de minimis.*
- A commodity trading advisor generally is a person who provides commodity interest trading advice for compensation or profit.
  - Exemptions are available for CPOs that provide advice solely for the use of the commodity pools they advise.

CPO/CTA Regulatory Requirements

- CPOs have Disclosure, Recordkeeping and Reporting Requirements:
  - Operators of hedge funds may claim relief under Rule 4.7 if all participants in the fund are Qualified Eligible Persons (QEPs).
    - *Disclosure document and prescribed disclosures are not required*
      - Offering Memorandum/Private Placement Memorandum not required to be submitted to NFA.
    - *Quarterly reports to participants instead of monthly*
      - Must still have an audited annual report submitted to NFA and distributed to participants within 90 days of year-end.
- CTAs have Disclosure and Recordkeeping Requirements:
  - If all advisory clients, including funds for which acting as sub-advisor, are QEPs, the advisor may claim relief under Rule 4.7.
    - *Disclosure document and prescribed disclosures not required.*
      - Disclosure document is not required to be submitted to NFA.

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CPO/CTA Regulatory Requirements (continued)

- CTA Taping Requirements:
  - Effective December 21, 2013, CFTC Rule 1.35 requires CTAs that are members of a Designated Contract Market (DCM) or Swaps Execution Facility (SEF) to tape record all oral communications concerning quotes, solicitations, bids, offer, instructions, trading and prices that lead to the execution of a transaction in commodity interests.
  - “Member” of a DCM or SEF is any person “having trading privileges”
  - Tapes must be maintained for 1 year

CPO/CTA Regulatory Requirements (continued)

- NFA Bylaw 1101
  - Prohibits an NFA member from doing business with a person required to be registered with the CFTC that is not also a member of NFA.
    - *Accordingly, NFA membership is essentially mandatory for all CPOs and for any CTA that is exercising discretion over client accounts.*
  - An NFA member must conduct due diligence to ensure that any persons with which it conducts business, including investors in any commodity pool, if required to be registered with the CFTC are also a member of NFA.

CPO/CTA Regulatory Requirements (continued)

– Although its terms impose strict liability, the NFA generally has not enforced the rule using this standard, but rather has brought cases where the Member knew or should have known of the violation.

– CPOs/CTAs generally include a Bylaw 1101 questionnaire in their account/subscription documentation and will conduct additional due diligence, for example by checking an entity's registration status on the NFA's web site.

CPO/CTA Regulatory Requirements (continued)

- NFA Compliance Rule 2-45 Prohibition of Loans by Commodity Pools to CPOs and Affiliated Entities
  - No Member CPO may permit a commodity pool to use any means to make a direct or indirect loan or advance of pool assets to the CPO or any other affiliated person or entity.

CPO/CTA Regulatory Requirements (continued)

– Submitted proposed Interpretive Notice that would permit:

- *Certain securities borrowings and securities loans in regard to short sales;*
- *Securities loans for cash financing with affiliate prime brokers documented under an MSLA;*
- *Guarantees of an affiliated entities obligations where liability is limited to the pool's investment in the entity;*
- *Repos and Reverse Repos with affiliates;*
- *Tax related loans, advances and distributions related solely to the CPO's or related party's taxable income arising from the pool; and*
- *Transactions permitted under the Investment Company Act of 1940 and Exemptive Orders and No-Action Letters issued under Sections 17 and 57 of the Investment Company Act of 1940.*

ISDA Protocols

- ISDA August 2012 DF Protocol
  - Addresses external business conduct, large trader reporting, position limits, recordkeeping and reporting rules.
  - Due ~~October 12, 2012~~
  - Due ~~December 31, 2012~~
  - Due May 1, 2013?
  - 7,317 adherents as of April 22, 2013 (many hedge funds)

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ISDA Protocols (continued)

- DF Terms Agreement
- Addendum I and Addendum II to Questionnaire
- Process
  - CICI
  - Adhere & Pay (per adherent per protocol)
  - Deliver questionnaires (ISDA Amend)
- Alternatives to August 2012 DF Protocol

ISDA Protocols (continued)

- ISDA March 2013 DF Protocol (a.k.a. Protocol 2)
  - Addresses
    - *confirmation, portfolio reconciliation, portfolio compression, and swap trading relationship documentation requirements for dealers and majors*
      - *general and product disclosures*
    - *end-user exception to clearing*
    - *clearing requirement determination*
  - 133 adherents as of April 22, 2013

ISDA Protocols (continued)

- ISDA March 2013 EMIR NFC Representation Protocol
  – Addresses know your counterparty requirements and non-financial counterparty representations
  – 3 adherents as of April 22, 2013

ISDA Protocols (continued)

- Future protocols to come
  - CFTC rules
  - SEC rules
  - EMIR, MiFiD and MiFIR

Swaps Clearing

- Dodd-Frank provides for mandatory clearing of standardized swaps, as determined by the CFTC
  - To date:
    - *Fixed-to-floating, floating-to-floating, forward rate agreement and overnight indexed interest rate swaps based on Euribor and Libor for specified tenors denominated in USD, EUR, GBP and Yen (other than overnight indexed);*
    - *Untranched CDX North America Investment Grade and High Yield indices for specified tenors; and*
    - *Untranched iTraxx Europe, iTraxx Europe Crossover and iTraxx Europe HiVol indices for specified tenors.*
- Clearing phased in
  - Active Funds (private funds with more than 200 swaps per month) clearing began on March 11, 2013 (interest rate and CDX) and April 26, 2013 (iTraxx)
  - Funds other than Active Funds and those managed as a third-party subaccount, June 10, 2013 (interest rate and CDX) and July 25, 2013 (iTraxx)
  - All others, including third-party subaccount (managed by an unaffiliated and independent asset manager that is responsible for documentation necessary for the account owner to clear), September 9, 2013 (interest rate and CDX) and October 23, 2013 (iTraxx)

Swaps Clearing (continued)

- Must establish account with an FCM clearing member
  - FCM account agreement;
  - OTC Clearing Addendum (FIA and ISDA); and
  - Cleared Derivatives Execution Agreement (FIA and ISDA)
- Will have to post initial and maintenance margin
  - DCO will set the margin, but FCM may require more
- CFTC Rules provide for segregation and custody of customer property for cleared swap transactions referred to as legal segregation with operational commingling (LSOC)
  - Cleared swaps customer collateral entered on the books of the FCM and DCO separately for each swaps customer (futures segregation where the DCO generally would not have customer specific information).
  - LSOC permits cleared swaps customer collateral to be commingled in single customer accounts at the FCM and DCO, but may not be commingled with proprietary funds of the FCM or DCO.
  - In the event of an FCM insolvency caused by a customer default, neither the DCO nor the FCM may use cleared swaps collateral of a non-defaulting customer to cover shortfalls of defaulting customers (futures DCO may apply other non-defaulting customer collateral for any shortfalls of defaulting customers).
  - Shortfalls from fraud, loss of value of invested customer collateral, or other non-customer specific risk, remain a risk shared pro-rata by all customers.

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"Commodity Interest" Guidance

The purpose of this chart is to provide guidance on the instruments that are considered to be "commodity interests" under Part 4 of the CFTC Regulations, and therefore must be included in determining the availability of certain exemptions from registration as a commodity pool operator (for example, under CFTC Regulation 4.13(a)(3)). CFTC Regulation 1.3(yy) defines "commodity interest" to include: (1) futures contracts; (2) commodity options and leverage transactions; (3) retail foreign exchange transactions; and (4) swaps. Because the commodity interest definition is broad, this is not intended to be, nor is it possible to create, an exhaustive list of all "commodity interests" but rather describes the major categories of commodity interests. We encourage you to contact us if you have questions as to whether a particular instrument is a commodity interest.

The "commodity interest" determination requires a two-step process. First, one must determine whether the particular instrument involves a "commodity." The definition of "commodity" under the Commodity Exchange Act (the "CEA") and CFTC Regulations is extremely broad, including a list of specifically enumerated commodities as well as "all services, rights, and interests…in which contracts for future delivery are presently or in the future dealt in."[1] Thus a commodity includes not just traditional physical commodities such as agricultural, metal and energy products, but also financial instruments, rates, events, indices, domestic or foreign, and other intangible items and contracts, whether foreign or domestic, that might not be settled through delivery, but rather through cash settlement. Second, one must determine whether the particular commodity contract is a derivative contract. Futures, swaps, options, and financially-settled forwards based on a commodity are all derivatives contracts. Spot contracts and physically-settled forwards between commercial market participants (which generally does not include investment funds) are not derivatives contracts. Derivatives contracts based on a commodity are commodity interests, and investments in a fund or account that trades in commodity interests are also deemed to be commodity interests.

As a general rule (with limited exceptions for certain physical forward, spot and security-based transactions), any U.S. or foreign futures contract, option on futures contract or swap traded on or subject to the rules of a U.S. contract market (futures exchange),[2] a foreign board of trade,[3] or a swap execution facility and/or cleared through a derivatives clearing organization[4] should be considered a "commodity interest." The term "commodity interest" does not include the purchase or sale in the spot market of physical commodities (such as bullion, where title to the bullion actually is transferred) or investments in an underlying instrument (such as treasury notes) but does include futures, swaps, options and financially-settled forwards on such commodities or instruments.

Additionally, in applying Part 4 of the CFTC Regulations, there are special rules for a fund (investor fund) that indirectly invests in commodity interests through its investment in another fund (an investee fund, for example, a hedge fund, ETF, mutual fund, or commodity pool) that invests in commodity interests. Depending on (i) the specific instruments in which the investee fund invests, (ii) the precise relationship between the investor fund and the

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[1] Section 1a(9) of the CEA. 7 U.S.C. §1a(9).
[2] Examples of the principal futures exchanges include: ICE Futures US, CME, NYMEX, CBOT, COMEX, NYSE Liffe, Eris, NADEX, KCBOT, and MGE. This is not a complete list.
[3] Examples of foreign boards of trade include: Eurex, HKFE, Euronext, LME, LIFFE, and ICE Futures Europe. This is not a complete list.
[4] Examples of derivatives clearing organizations include: ICE Clear, CME, LCH, and NYPC. This is not a complete list.

investee fund, (iii) the registration status of the commodity pool operator of the investee fund, and (iv) the level of trading in investee funds and direct investments in commodity interests, the investor fund will be required to take into account the commodity interests of the investee fund. We encourage you to contact us if you have questions about the calculation of indirect investment in commodity interests.

Special consideration should be given to swaps, which are "commodity interests"[5] and now subject to CFTC regulation, and security-based swaps, which are not "commodity interests" and are subject to SEC regulation.

The definition of "swap" is defined in the CEA and CFTC rulemaking to include:

- Contracts that provide for the exchange of payments based on the value of rates (e.g., interest rate swaps), commodities (e.g., commodity swaps), exempt securities (e.g., a swap on government or municipal securities), instruments of indebtedness (e.g., a debt swap), indices (e.g., an index swap on a broad-based foreign or domestic securities index), quantitative measures, or other financial or economic interests.
- Options on rates, commodities, exempt securities, indices, debt, or other financial or economic interests.[6]
- Contracts that provide for purchase, sale, payment or delivery based on a contingent event.
- Currency swaps (e.g., the exchange of principal and interest in one currency for the same in another currency), currency options, cash-settled foreign exchange forwards (i.e., non-deliverable forwards), foreign currency options, foreign exchange options and foreign exchange rate options.[7]
- Forward rate agreements.
- Contracts that are commonly known to the trade as a swap.

Security-based swaps, which are not "commodity interests," include any swap that is based on: (i) a narrow-based security index (e.g., an index swap on a narrow-based securities index), (ii) a single security (other than an exempt security) or loan (e.g., an equity option on an individual security), and (iii) the occurrence or non-occurrence of an event relating to a single issuer of a security or the issuers of a narrow-based security index (e.g., a single-name credit default swap).

[5] See, e.g., definition of "commodity pool" in Section 1a(10) of the CEA. 7 U.S.C. 1a(10).
[6] An option on an equity index is considered a security and is not a swap.
[7] Physically-settled foreign exchange forwards and foreign exchange swaps (e.g., the exchange of two different currencies at a fixed rate on a specific date) are excluded from the "swap" definition as a result of a determination made by the Secretary of Treasury in accordance with the CEA.

Instructions: First, locate the underlying product or product category of the instrument. Second, locate the type of instrument to determine whether it is or is not a commodity interest.

Please note: This list is provided for guidance only and is not a comprehensive list of all commodity derivatives that may be considered a commodity interest. We have included the most common type of commodity interests, but, for example, this list does not include every agricultural product, type of metal, stock index, or interest rate, etc. upon which a derivative is, or may be, traded. If an underlying product has not been included on this list, it does not necessarily mean that it is not a commodity interest.

UNDERLYING PRODUCT[8]	**INSTRUMENTS CONSIDERED "COMMODITY INTERESTS"**[9]	**INSTRUMENTS NOT CONSIDERED "COMMODITY INTERESTS"**
Agricultural Products, for example: • Corn • Wheat • Soybeans • Soybean Oil • Soybean Meal • Rice • Oats • Barley • Rye • Flaxseed • Peanuts • Peanut Oil • Palm Oil • Cottonseed • Cottonseed Oil • Cottonseed Meal • Fats and Oils • Grain Sorghums • Mill Feeds • Cocoa • Coffee • Cotton • Sugar • Orange Juice • Potatoes • Lumber • Tobacco • Horticultural Products • Cattle • Hogs • Wool • Wool Tops • Lard • Tallow • Livestock • Livestock Products • Butter • Eggs • Dairy Products • All other products that were derived from living organisms and are used for human food, shelter, animal feed or natural fiber • Commodity-based indexes based on underlying agricultural commodities	• Futures contracts • Options on futures • Forward contracts (cash-settled) • Swaps • Commodity options	• Spot contracts • Forward contracts (physically-settled between commercial market participants) • Physical commodities

[8] The CEA specifically excludes onions and motion picture box office receipts from the definition of "commodity."
[9] Investments in a fund or account that trades in commodity interests (e.g., a hedge fund, ETF, mutual fund, or commodity pool) are also deemed to be commodity interests.

UNDERLYING PRODUCT[8]	INSTRUMENTS CONSIDERED "COMMODITY INTERESTS"[9]	INSTRUMENTS NOT CONSIDERED "COMMODITY INTERESTS"
Metals, for example: • Gold • Silver • Platinum • Palladium • Copper • Lead • Aluminum • Nickel • Tin • Zinc • Steel • Uranium	• Futures contracts • Options on futures • Forward contracts (cash-settled) • Swaps • Commodity options	• Spot contracts • Forward contracts (physically-settled between commercial market participants) • Bullion • Physical commodities
Energy Products, for example: • Crude Oil • Ethanol • Natural Gas • Heating Oil • Coal • Gasoline • Diesel • Jet Fuel • Propane • Power/Electricity	• Futures contracts • Options on futures • Forward contracts (cash-settled) • Swaps • Commodity options	• Spot contracts • Forward contracts (physically-settled between commercial market participants) • Physical commodities
Equity Indexes (Broad-Based), for example: • DJIA • S&P 500 • S&P MidCap 400 • S&P SmallCap 600 • Nasdaq 100 • Russell 1000 • Russell 2000 • Russell 1000 Value • Russell 1000 Growth • FTSE 100 • Nikkei • STOXX Europe 50 • STOXX Europe 600 • Dax • Hang Seng • MSCI Japan • Ibovespa • S&P/TSX 60 • Any other foreign or domestic index that is not a "narrow-based" index.[10]	• Futures contracts • Options on futures • Swaps, including: o Equity index swaps o Debt index swaps	• Options, Swaps on a Equity Index
Interest Rates and Debt Securities, for example: • U.S. Treasuries • Fed Funds Rate • Eurodollar • Euribor • Euroyen • Gilt • Bund/Babl/ Schatz • DTCC GCF Repo Index Futures • Sovereign Debt	• Futures contracts • Options on futures • Interest Rate Swaps, including: o Fixed v. floating o Rate floor o Rate collar o Cross-currency rate swap • Commodity options	• U.S. Treasuries • Agency securities • Sovereign debt • Corporate bonds • Debt securities
Credit Products, for example:	• Broad-Based Index	• Single-Name Credit

[10] The CFTC considers a security index "narrow-based" if it meets any one of the following criteria:
(i) The index is composed of fewer than 10 securities;
(ii) Any single security accounts for more than 30% of the total index weight;
(iii) The five largest securities together account for more than 60% of the total index weight; or
(iv) The lowest-weighted securities that together account for 25% of the total weight of the index have an aggregate dollar value of average daily trading volume of less than US$30 million (or US$50 million if the index includes fewer than 15 securities).

UNDERLYING PRODUCT[8]	INSTRUMENTS CONSIDERED "COMMODITY INTERESTS"[9]	INSTRUMENTS NOT CONSIDERED "COMMODITY INTERESTS"
• Single-name Credit Default Swaps • Index Credit Default Swaps	Credit Default Swaps	Default Swaps • Narrow-Based Index Credit Default Swaps
Foreign Exchange/Currencies	• Retail foreign exchange transactions • Foreign exchange futures • Rolling spot transactions • Forward rate agreements • Non-deliverable forwards • Currency swaps (the exchange of principal and interest in one currency for the same in another currency)	• Spot foreign exchange transactions (other than rolling spot) • Options on foreign exchange traded on a securities exchange • Foreign exchange forwards (deliverable) and foreign exchange swaps (the exchange of two different currencies at a fixed rate on a specific date)
Economic Indexes or Rates, for example: • Consumer Price Index • Unemployment Rate • Commodity Indexes	• Futures contracts • Options on futures • Swaps	
Equity Securities	• Security futures (single-stock futures and futures on narrow-based indexes) • Futures on exempt securities	• Equity securities • Security-based swaps • Options on securities
Emissions, for example: • EUAs • CERs	• Futures contracts • Options on futures • Swaps	• Forward contracts (physically-settled between commercial market participants) • Emission allowance certificates
Weather	• Futures contracts • Options on futures • Swaps	
Real Estate Indexes, for example: • S&P/Case-Shiller Home Price Index	• Futures contracts • Options on futures • Swaps	• Real property • REITs
Freight	• Futures contracts • Options on futures • Swaps	• Forward contracts (physically-settled between commercial market participants)

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Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

Lessons of Litvak: The Trade Negotiation Process

Robert C. Mendelson

Ivan P. Harris

May 2, 2013

www.morganlewis.com

The Stuff of Wall Street

- What we are constantly exchanging, over the incredible network of wires, are quotations, orders, bluffs, fibs, lies and nonsense. The first four are the necessary agenda of doing brokerage in securities. The downright lies are rather exceptional, and in the long run prove to be unprofitable business practice.
- From **<u>Where Are the Customers' Yachts: or A Good Hard Look at Wall Street</u> ,** Fred Schwed Jr., Wiley Investment Classics, NY New York.
- This was written in **1940**

What Litvak Is Alleged To Have Done: Per The SEC Complaint

- SEC Press Litigation Release and Complaint
  - http://www.sec.gov/litigation/litreleases/2013/lr22602.htm
  - http://www.sec.gov/litigation/complaints/2013/comp-pr2013-12.pdf
- Price:
  - On numerous occasions from 2009 to 2011, Litvak lied to, or otherwise misled, customers about the price at which his firm had bought the MBS and the amount of his firm's compensation for arranging the trades.
  - At paragraphs 28 and 29 of the complaint give a specific example of him telling a customer he paid 42 and 4 ticks when he paid 41 and 4 ticks is given.

Allegations

- Source of Bonds
  - On some occasions, Mr. Litvak also misled the customer into believing that he was arranging a MBS trade between customers, when he really was selling the MBS out of the firm's inventory.
  - Paragraphs 35 to 37 give a specific example in which he appears to have represented that he was negotiating with a seller to sell to him so he could reoffer to his buying customer when he had actually acquired the bonds for the firm six days before.

Allegations (continued)

- SEC's view of what was misleading:
  - Mr. Litvak's misconduct misled customers about the market price for the MBS, and, thus, about the transaction they were agreeing to.
  - Mr. Litvak also misled customers about whether they were getting the best price for their MBS trades and how much money they were paying in compensation.

Overlay of Dealing with PIPP Funds

- Alleged Criminal Violations:
  - When the PIPP program was established, 18 U.S.C Section 1031(a)(2) was amended to include "TARP Fraud" as a crime.
  - Litvak was also charged under 18 U.S.C 1001 with making false statements to the government by virtue of his statements to PPIP fund managers.
  - Note also that he was arrested by "SIGTARP Agents." SIGTARP was created by the Section 121 of the Emergency Economic Stabilization Act of 2008.
  - The indictment is available here: http://www.structuredfinancelitigation.com/files/2013/01/USA-v-LITVAK-INDICTMENT-USDC-CONNECTICUT.pdf

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Lessons and What Can Be Done To Protect Your Firm and Personnel

- How to supervise nuanced and fast paced dialogue in either electronic or verbal form.
- This lends itself to
  - training,
  - tone from the top,
  - policy not procedure,
  - Oh and did I say <u>training?</u>
- Should you have compliance people with your organizations traders so they can hear one side of, or pick up a line and listen in?

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,	)	Civil Action No.
v.	)	
JESSE C. LITVAK, Defendant	)	JURY TRIAL DEMANDED

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") alleges the following against defendant Jesse C. Litvak ("Litvak"):

SUMMARY

1. This case involves misrepresentations and misleading conduct by Litvak while he bought and sold mortgage-backed securities ("MBS") as a senior trader at Jefferies & Company, Inc. ("Jefferies"), a broker-dealer. Part of Litvak's job involved arranging trades between his customers, meaning that he would buy a MBS from one customer and then sell it to another customer. On numerous occasions from 2009 to 2011, Litvak lied to, or otherwise misled, customers about the price at which his firm had bought the MBS and the amount of his firm's compensation for arranging the trades. On some occasions, Litvak also misled the customer into believing that he was arranging a MBS trade between customers, when Litvak really was selling the MBS out of Jefferies' inventory. Litvak's misconduct misled customers about the market price for the MBS, and, thus, about the transaction they were agreeing to. Litvak also misled customers about whether they were getting the best price for their MBS trades and how much

money they were paying in compensation. MBS are generally illiquid and discovering a market price for them is difficult. Participants trading in the MBS market must rely on informal sources, including their broker, for this information.

2. Jefferies' customers owed fiduciary duties to their clients. Jefferies' customers included funds which were established by the United States government under a program designed to help strengthen the markets for MBS during the financial crisis. Had Jefferies' customers been aware that they could have paid less for the MBS they purchased, they would have made an effort to do so.

3. Litvak engaged in the misconduct to facilitate the purchase and sale of MBS and earn more revenue for Jefferies. By engaging in the misconduct, Litvak generated over $2.7 million in additional revenue for his firm. Litvak also sought to improve his own standing at Jefferies. Litvak's bonus was determined in part by the amount of revenue he generated for the firm.

4. By engaging in the conduct alleged herein, Litvak violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. Based on these violations, the Commission seeks: (1) entry of a permanent injunction prohibiting Litvak from further violations of the relevant provisions of the federal securities laws; (2) disgorgement of Litvak's ill-gotten gains, plus pre-judgment interest; (3) the imposition of a civil monetary penalty due to the egregious nature of Litvak's violations; and (4) such other and further relief as the Court deems just and proper.

JURISDICTION AND VENUE

5. The Commission brings this action pursuant to the enforcement authority conferred upon it by Section 20(b) of the Securities Act [15 U.S.C. §77t(b)] and Section 21(d) of the Exchange Act [15 U.S.C. §§78u(d)].

6. This Court has jurisdiction over this action pursuant to Sections 20(b) and (d) and 22(a) and (c) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d), and 77v(a),77v(c)] and Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§78u(d), 78u(e), and 78aa].

7. Venue is proper in this district pursuant to Section 22(a) of the Securities Act [15 U.S.C. §77v(a)] and Section 27 of the Exchange Act [15 U.S.C. §78aa], because certain of the transactions, acts, practices, and courses of business constituting the violations alleged herein occurred within the District of Connecticut.

8. In connection with the conduct alleged in this Complaint, Litvak directly or indirectly made use of the means or instruments of transportation or communication in interstate commerce, the facilities of a national securities exchange, or the mails.

9. Litvak's conduct involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements, and resulted in substantial loss, or significant risk of substantial loss, to other persons.

10. Unless enjoined, Litvak will continue to engage in the securities law violations alleged herein, or in similar conduct that would violate the federal securities laws.

DEFENDANT

11. Jesse C. Litvak, age 38, is a resident of New York, New York.

12. Litvak was associated with Jefferies, a broker-dealer, from approximately April 2008 to December 2011. He served as a managing director and was a trader in Jefferies' MBS group. He worked at Jefferies' offices in Stamford, Connecticut.

13. Jefferies, a Delaware corporation, has been registered as a broker-dealer with the Commission since September 17, 1969. Jefferies is a member of the Financial Industry Regulatory Authority ("FINRA"). Its primary office is in New York, New York.

FACTUAL ALLEGATIONS

A. Background

14. Litvak was an experienced MBS trader who joined Jefferies in 2008. A MBS is a type of security whose underlying assets are commercial or residential loans. (MBS, which are debt instruments, are sometimes referred to as "bonds.") As a senior MBS trader at Jefferies, Litvak arranged trades between buyers and sellers of MBS and purchased and sold securities for and out of Jefferies' inventory. The MBS consisted of both non-agency residential mortgage-backed securities ("RMBS") (those issued by non-government institutions) and commercial mortgage-backed securities ("CMBS"). Investors in these securities receive payments from the interest and principal payments on the underlying mortgages.

15. These were illiquid securities, and many of the MBS that Litvak traded had been discounted significantly since the 2007-2008 financial crisis. The market for MBS is opaque: there is no exchange that shows the buy and sell price for each trade. Therefore, the buyer of the MBS has no way to learn the price paid by the broker, unless the broker chooses to tell its customer.

16. The price of the MBS is expressed as a percentage of its par value. A price or level of "100" means that the MBS is trading at 100 percent of its par value. Similarly, a price or level of "90" means that the MBS is trading at 90 percent of its par value.

17. As an intermediary, Litvak generally purchased MBS from one customer and then sold the same security to another customer. In those circumstances, Jefferies and Litvak typically re-sold the MBS on a riskless, principal basis; this meant that, while Jefferies would momentarily own the MBS in a principal account, it had minimal or no risk because it knew that it could re-sell the MBS to another customer. Litvak earned compensation for Jefferies by re-selling the MBS at a higher price and collecting the spread (or difference) between the purchase price and the sale price. The customers were aware that Jefferies was compensated in this way, and the amount and source of the compensation were part of the negotiations around the purchase and sale of the MBS.

18. Litvak sometimes offered the customers an "all-in" price for a MBS that incorporated both the purchase price for the security and Jefferies' compensation; on other occasions, Litvak and the customers agreed that Jefferies' compensation would be in addition to, or "on top of," the acquisition price for the MBS.

19. Jefferies' traders and their customers often discussed the amount of Jefferies' compensation in terms of the number of "ticks" that Jefferies would receive on a trade. One "tick" equals 1/32 of a point. For example, a price of 65-16 refers to 65 and 16 ticks or $65^{16/32}$ (or 65.5).

20. Jefferies' customers were funds that invested in MBS. Some of them were Legacy Securities Public-Private Investment Program ("PPIP") funds established by the United States government. Under PPIP, the U.S. Department of Treasury ("U.S. Treasury") invested in

funds advised by private sector fund managers for the purpose of purchasing "eligible assets," typically debt securities that had been issued prior to 2009 and that had originally been given the highest ratings (such as AAA) by a nationally recognized statistical rating organization. PPIP was designed to help support the market for MBS in the wake of the financial crisis. Initially, the U.S. Treasury selected nine investment advisers to serve as PPIP managers, including several that became customers of Jefferies' (AllianceBernstein, LP ("AllianceBernstein"); Angelo, Gordon & Co., LP ("Angelo Gordon"); Blackrock, Inc. ("Blackrock"); Invesco, Ltd. ("Invesco"); and Wellington Management, LLP ("Wellington")). Other customers were hedge funds or non-PPIP funds.

21. The MBS market operates through relationships between customers, who buy and sell the bonds, and broker-dealers, like Jefferies, that arrange the trades. Customers seek to pay the lowest price for purchases and get the highest price on sales. It is not unusual for a customer's view of the current market price for a security to come from the broker-dealer that is selling the security. Because of this, there is an emphasis on establishing relationships, building trust, and having a good reputation within the industry. In part because of the opacity of the market, and in part because the market relies on repeat transactions between the same parties, customers seek to avoid broker-dealers who are not honest with them. Upon learning that Litvak had lied to them about the price he paid for MBS, some customers indicated that their firms would have temporarily stopped doing business with Jefferies had they known the truth. At least one customer, upon learning that Litvak had lied, temporarily stopped doing business with Jefferies. Some customers indicated they would have sought lower prices on trades, or even tried to re-negotiate trades, had they known the truth.

B. Litvak's Misconduct

22. From 2009 to 2011, Litvak engaged in misconduct on over 25 trades. In each instance, Litvak made misrepresentations to, or otherwise misled, customers about the price at which Jefferies had purchased the MBS before re-selling it to the customer and Jefferies' compensation for arranging the trade. In some cases, Litvak also pretended to be arranging the trade between customers when Jefferies was actually selling MBS out of its own inventory.

23. When Litvak offered customers MBS, he lied to them about how much Jefferies had paid (or was paying) for the securities. In order to negotiate a higher sale price to the customers, Litvak misled them into believing that Jefferies had paid a higher price for the MBS than it actually had.

24. By misrepresenting Jefferies' purchase price, Litvak misled customers about the amount of compensation Jefferies would receive on the transaction. For example, if Litvak told the customer that Jefferies' purchase price was 80 and the sale price was 80 and 4 ticks, the customer understood that Jefferies received 4 ticks in compensation. However, if Jefferies' purchase price was actually 79 and the sale price was 80 and 4 ticks, then Jefferies received an extra point in compensation as a result of Litvak's misrepresentation. On some occasions, Litvak and the customer explicitly agreed on the amount of Jefferies' compensation based on the purchase price as represented by Litvak.

25. Sometimes, in addition to misrepresenting the price and Jefferies' compensation, Litvak also misled his customers into believing that Jefferies was arranging a trade between two customers, when Jefferies actually was selling a MBS out of its own inventory. In these instances, Litvak pretended to be actively negotiating with an outside party to buy a MBS that he would then re-sell to his customer. Litvak communicated precise details to customers about

the state of negotiations with the imaginary seller. But none of these negotiations were taking place; instead, Litvak fabricated the existence of the seller and every detail about active negotiations with it. In fact, as Litvak knew, Jefferies had purchased these MBS days (and even months) before and already held them in its inventory.

26. In many cases, Litvak's misrepresentations were made in electronic communications such as instant messages, emails, and online chats.

May 28, 2009 Trade with MFA

27. While arranging a trade on May 28, 2009, Litvak lied to both the seller and buyer of $25 million of a MBS called IndyMac INDX Mortgage Loan Trust ("INDX") 2007-AR7 2A1 (INDX 2007-AR7 2A1).

28. A representative of MFA Mortgage Investments, Inc. ("MFA") told Litvak he was interested in bidding 42-00 for $25 million in the INDX MBS. After negotiating with the seller, Litvak told the MFA representative in an instant message, "I can sell to you at 42-8 . . . I Bot EM AT at 42-4." MFA agreed to buy the MBS at 42-8.

29. Litvak lied to MFA about the acquisition price. He had bought the security at 41-4, not "42-4" as he had reported. The next day, Litvak admitted to a Jefferies colleague that he had lied to MFA, while also misrepresenting the purchase price to his colleague. Litvak wrote, "we bot at 41-12. Sold to him a[t] 42-8. He thinks we bot em @42-4 fyi." Thus, he misrepresented the purchase price (41-4) both to MFA and to his own colleague.

30. While he was lying to the buyer, Litvak was also lying to the seller of the MBS, Third Point LLC ("Third Point"). Although he knew MFA was willing to pay 42-00 for the MBS, Litvak told a Third Point representative that the MFA representative—whom Litvak

referred to as "one of my circle of trust guys"—had bid only 41-00. Litvak then reported that he had convinced MFA to raise its bid to 41-16.

31. Litvak acknowledged to a Jefferies colleague that he misled Third Point, writing, "So we bot [INDX] bonds from [the Third Point representative] at 41-4. . . . she thinks we sold at 41-16 . . . we really sold em at 42-8."

32. Through his misconduct, Litvak generated more than $200,000 in extra profit for Jefferies on this trade.

December 9, 2009 Trade with Redtop

33. On December 8, 2009, Litvak sent an instant message to a representative at Redtop Investors LLC ("Redtop") inquiring about a MBS called New York Mortgage Trust 2005-2 A (NYMT 2005-2-A). Litvak asked, "what u think of this nymt trade[?]"

34. The next day, December 9th, Litvak reported back to both the first and a second Redtop representative that he had purchased the MBS, providing precise details of a negotiation with the seller:

> we are good bro…he is selling to me at 79-24…i convinced him that is a rounding error from 80 and he laughed and agreed…13.3 mm orig of nymt 05-2a can be yours for the price of 80…

35. After receiving this information, Redtop agreed to purchase the MBS at 80.

36. Litvak misled Redtop into believing that Litvak was conducting active negotiations on Redtop's behalf. In reality, Jefferies had purchased the MBS on December 3 (six days earlier) and owned the MBS in its inventory. Litvak made up the supposed seller and fabricated the details of the negotiation.

37. Litvak also lied to Redtop about the purchase price and, thus, Jefferies' compensation on the trade. Litvak did not purchase the MBS at "79-24" as represented to Redtop, but at 72-8.

38. Through his misconduct, Litvak made over $410,000 more for Jefferies on this trade.

December 23, 2009 Trade with Wellington

39. On December 23, 2009, Litvak approached a representative at Wellington Management LLP ("Wellington") about purchasing a MBS called Wells Fargo Mortgage Backed Securities 2006-AR12 1a1 (WFMB 06-AR12 1a1). Litvak suggested to the representative that he was arranging a trade with an active outside party:

> yo yo yo….if there is any color you can share on your wfmbs 06-ar10 4A1 from yest…maybe i can use that as leverage to go beat the guy up that owns the 06-ar12 1a1 bonds….as of late last nite it sounded like he was starting to warm up to the idea of coming off his level…..

40. The Wellington representative asked Litvak, "what's the current size and offer" on the MBS, and Litvak responded, "its 3+mm current and he was offering them at 77…." About twenty minutes later, Litvak reported that the seller was not in yet: "he … usually rolls in around now…..so should know soon brotha….." Half an hour later, Litvak told the Wellington representative that he had bought the MBS at 75-28 and provided details of the supposed negotiation:

> winner winner chicken dinner…he is gonna sell em to me at 75-28 as I told him to not get cute and just sell the bonds so you can own them at 76….he said cool…..its 6.23mm orig….a'ight?

41. Wellington agreed to purchase $6.23 million of the MBS at 76.

42. In actuality, Jefferies had purchased the MBS on December 14, 2009 at 70 (not "75-28") and held it in its inventory at the time of the sale to Wellington. On December 23, 2009, Litvak concocted the supposed seller and fabricated the details of a negotiation. As he had done before, Litvak lied about the purchase price, Jefferies' compensation on the trade, and the fact that the MBS was being sold out of Jefferies' inventory.

43. Through his misconduct, Litvak made over $150,000 in additional compensation for Jefferies on this trade.

January 7, 2010 Trade with York

44. On January 7, 2010, Litvak communicated with a representative at York Capital Management Global Advisors, LLC ("York") about selling $40 million of a MBS called DLSA Mortgage Loan Trust 2006-AR1 2A1A (DLSA 2006-AR1 2A1A), held by York, to another customer. Litvak told the representative that the other customer had bid 60-24. The York representative asked Litvak how much he wanted to be compensated for the trade:

Litvak:	i am happy when I get any trades…..lol…in all seriousness….i think 8/32s is great….so maybe you sell em to me at 60-28 and i sell em to him at 61-4….something like that..but im also happy to get you 61 and just tell him to pay me 61-8…..wanna get you the highest i can…
York representative:	well i want best execution obv so try to get him to 61-8!
Litvak:	we are doneski gorgeous! im selling him bonds at 61-8……will buy em from you at 61 k?. . .
York representative:	great! . . . .

45. As a result of this back-and-forth, York agreed to sell the MBS at 61.

46. Litvak misrepresented the resale price and the compensation he would receive for Jefferies. He did not sell the MBS at "61-8," as stated, but at 62-12. Thus, instead of the "8/32s" he represented Jefferies would make, the firm actually was compensated 44 ticks for the trade.

47. Through his misconduct, Litvak made over $220,000 more for Jefferies on this trade.

March 29, 2010 Trade with QVT

48. On March 29, 2010, Litvak learned from a Jefferies colleague that Jefferies was going to buy $3.1 million of a MBS called Countrywide Alternative Loan Trust 2006-OA3 1A1 (CWALT 2006-OA3 1A1) at 50-16. Litvak then approached a representative at QVT Financial,

LP ("QVT") about purchasing the MBS. Although Litvak knew Jefferies was buying the MBS at 50-16, he told the representative, "i have a small guy showing me 3.1mm orig of cwalt 06-oa3 1a1 at 51-16 . . . . i can prob buy the bonds from him at 51-8 and sell em to you at 51-12 if you want . . . ."

49. The QVT representative told Litvak he was interested in the MBS and that he trusted Litvak to get him the best price:

QVT representative:	I would take them from you – obviously cheaper the better, but if you think 51-12 is the cheapest they come, I'll trust you on that
Litvak:	ok….let me just cal the guy and see if i can get em at 51 …brb [be right back]
QVT representative:	thanks
Litvak:	winner winner!!! Bot em at 51-00 big man!! 3.1mm orig
QVT representative:	wanna say 51-06 (you just earned yourself 2 extra tics)?

50. Litvak lied to QVT about the acquisition price. Jefferies bought the MBS at 50-16, not "51-00" as represented. Litvak thus also lied about Jefferies' compensation. QVT purchased $3.1 million of the MBS at 51-6. As a result, Jefferies earned 22 ticks on the trade and not the 4 ticks Litvak offered, nor the 6 ticks the grateful buyer eventually agreed upon.

51. Through his misconduct, Litvak made more than $5,000 more for Jefferies on this trade.

March 31, 2010 Trades with AllianceBernstein

52. On March 31, 2010, Customer A, an investment adviser to a private fund, asked Jefferies to find buyers for several MBS, including Lehman XS Trust Series 2007-15N 2A1 (LXS 2007-15N 2A1) and Harborview Mortgage Loan Trust Mortgage Loan Pass-Through

Certificates, Series 2006-10 2A1A (HVMLT 2006-10 2A1A). Litvak approached a representative at AllianceBernstein about buying the MBS.

53. Litvak told the AllianceBernstein representative that the seller had offered to sell the HVMLT MBS at 58-00 and the LXS MBS at 58-8:

Litvak:	he will sell to me 20mm orig of hvmlt 0610 @ 58-00 but he is being harder to knock back on the lxs bonds…said that he thinks that one is much cheaper yada yada yada…he told me he would sell them to me at 58-8 (30mm orig)…I would be fine working skinnier on [] these 2…but think you are getting good levels on these…
Representative:	is he paying u or am I?
Litvak:	all the levels I put in this room are levels he wants to sell me…I will work for whatever you want on these…. so to recap levels he is offering to me: hvmlt 06-10 2a1a (20mm orig) @ 58-00 lxs 40mm orig at 58-8… Bot em
Representative:	Can u wash the hvmlt and [add] 5 ticks to lxs?...
Litvak:	thats fine.

54. Litvak misrepresented to AllianceBernstein the prices at which Jefferies had acquired the MBS for re-sale. Litvak bought the HVMLT MBS at 57-16 (not the “58-00” he told Alliance Bernstein) and he acquired the LXS MBS at 56-16 (not “58-8” he represented).

55. Litvak also misrepresented the compensation that Jefferies would receive for these trades. AllianceBernstein purchased the $20 million HVMLT MBS at 58 and $40 million of the LXS MBS at 58-13. As a result, on the HVMLT trade, Litvak made 16 ticks for Jefferies; he did not work for free (or “wash” the trade) as he had agreed. And, on the LXS MBS, Litvak made 61 ticks for Jefferies; he did not work for “5 ticks” as agreed.

56. As a result of his misconduct, Litvak made over $600,000 more for Jefferies on the LXS trade and over $50,000 more on the HVMLT trade.

April 1, 2010 Trade with AllianceBernstein

57. Customer A also asked Jefferies to find buyers for a MBS called Residential Accredit Loans, Inc., Series 2007-QH1 A1 (RALI 2007-QH1 A1). On April 1, 2010, in an effort to find a buyer, Litvak went back to the representative at AllianceBernstein, first offering the bond at 57 and claiming to have traded $25 million of the same MBS at 57 that morning. The representative asked, "is 57 the best we can do?" Litvak promised to go back to the seller to try to push down the price. The representative urged, "bid 'em best u can." Litvak then told the representative that the seller "will sell me bonds at 56-24" and that "i would work for 2-4/32s on these with you . . . ." AllianceBernstein agreed to pay Jefferies 4 ticks and bought $25 million of the MBS at 56-28.

58. Litvak lied about Jefferies' acquisition price. Jefferies did not buy the MBS at "56-24," as he stated, but at 56. He also lied about Jefferies' compensation. Jefferies received 28 ticks for the trade, not the "2-4/32s" Litvak said he would work for, nor the 4 ticks AllianceBernstein agreed to pay Jefferies for the trade.

59. As a result of his misconduct, Litvak made more than $140,000 more for Jefferies on this trade.

April 1, 2010 Trade with QVT

60. On April 1, 2010, Customer A sold Litvak another $45 million of the LXS 2007-15N 2A1 MBS at 56-16. Later the same day, Litvak approached a representative at QVT about buying the bonds.

61. The QVT representative told Litvak he was interested in the MBS and would "pay 56-8 to me." Although Jefferies already owned the MBS, Litvak pretended that he was arranging the trade with an outside party. Litvak agreed to "show" the seller QVT's bid, but cautioned, "gonna be hard to get em that low given where we just traded 25mm of em . . . but i will ask." Litvak then reported back, "sorry bro . . . . he said he would sell at 58 (which means I can buy em 8/32s cheap to that)…he is letting me work for 8/32s on these trades….so 58 to you is gonna be best."

62. When QVT agreed to raise its bid to 57-00, Litvak again pretended to negotiate with the "seller" and told the QVT representative that the seller "just told me he was firm at 57-16…..if i call him back and go lower he is gonna rip my head off….i just know it . . . he already is giving me sht that I sold the 1st piece at 59."

63. Litvak then told QVT that he "would be willing to work super skinny just to try and get er done," and agreed to "work" for "2/32s." With that representation, QVT Financial purchased $20.868 million of the MBS at 57-18.

64. Litvak lied to QVT about Jefferies' acquisition price (which was 56-00, not "57-16"), the compensation (which was 34 ticks, not "2/32s"), and the source of the MBS (pretending to negotiate with an active seller when Jefferies already owned the bond).

65. As a result of his misconduct, Litvak made over $170,000 more for Jefferies on this trade.

April 23, 2010 Trade with Blackrock

66. On April 23, 2010, Litvak learned from a Jefferies colleague that a customer wanted to sell $2 million of a MBS called GMACM Mortgage Loan Trust 2006-AR1 2A1

(GMACM 2006-AR1 2A1) at 80-00. Litvak then approached a representative at Blackrock, Inc. ("Blackrock") about purchasing the MBS.

67. Although Litvak knew the seller was willing to sell at 80-00, Litvak told Blackrock,"i have a guy that has 2mm orig and he wants to sell em at 81-16." Two hours later, Litvak told Blackrock that he had bought the GMACM MBS at 81, and Blackrock agreed to buy the MBS from Jefferies at 81-4.

68. Litvak misrepresented the acquisition price. Jefferies acquired the MBS at 80-00, not 81, as represented. Litvak thus also lied about Jefferies' compensation. Jefferies was paid 36 ticks, not the 4 ticks Blackrock agreed to.

69. Through his misconduct, Litvak made over $10,000 more for Jefferies on this trade.

May 3, 2010 Trade with Angelo Gordon

70. On May 3, 2010, Litvak approached a representative at Angelo Gordon about buying more of a MBS called BSARM 2007-4 22A1. Jefferies had bought $755,000 of the MBS on April 29th at 74. Although he knew the MBS was in Jefferies' inventory, Litvak pretended that he was arranging a trade with an active outside party. Litvak told the Angelo Gordon representative that the phantom seller was "offering me bonds at 77.50" and that "i was gonna bid him 75 and see what he says." The representative agreed to "buy em, up 8 to me . . . . wherever u get em." In other words, Angelo Gordon told Litvak that it would pay Jefferies 8 ticks over Jefferies' purchase price.

71. Litvak then pretended to negotiate with the phantom seller, telling the Angelo Gordon representative, "he came back to my 75 bid with a 77 counter…i fok'd him at 76 and waiting to hear back…im not worried…..i will call him in a sec." Minutes later, Litvak reported,

"we[']re good bro…76-8 ok?" Angelo Gordon bought $755,000 of the MBS at 76-8, or 8 ticks over Litvak's represented purchase price of 76.

72. Litvak lied about Jefferies' acquisition price (74, not "76"), Jefferies' compensation (72 ticks, not 8 ticks) and the source (pretending to be arranging a trade when Jefferies owned the MBS in its inventory).

73. As a result of this misconduct, Litvak made over $10,000 more for Jefferies on this trade.

May 4, 2010 Trade with AllianceBernstein

74. On May 4, 2010, Litvak told a representative at AllianceBernstein that he may be able to buy $30 million of a MBS called Washington Mutual Mortgage Pass-Through Certificates, Series 2006-AR14 1A1 (WAMU 2006-AR14 1A1) at 89-16 and resell the MBS to AllianceBernstein. The AllianceBernstein representative said he was interested, and soon after, Litvak reported, "winner winner chicken dinner….he will sell me 30mm orig at 89.5 bro….i will work for whatever you want on this one." The AllianceBernstein representative agreed to buy the MBS and told Litvak to "tack on 4 ticks" as compensation. Jefferies sold the MBS to AllianceBernstein at 89-20.

75. Litvak misrepresented the acquisition price and the compensation he would receive for Jefferies. Jefferies bought the MBS at 88-24, not at "89.5" as stated. Jefferies was compensated 28 ticks, not "4 ticks" as agreed.

76. As a result of his misconduct, Litvak made over $60,000 more for Jefferies on this trade.

May 13, 2010 Trade with Putnam

77. On May 13, 2010, Litvak approached a representative at Putnam Investment Management, LLC ("Putnam") about buying $20 million of a MBS called Morgan Stanley Mortgage Loan Trust 2007-11AR 2A5 (MSM 2007-11AR 2A5). Litvak told the Putnam representative that he had bought the MBS for "m53s" or mid-53s: "I just bot the msm 07-11ar 2a5 bonds . . . . paid m53s on em…. would sell those to you guys if u cared." Putnam purchased the MBS at 54.

78. Litvak misrepresented the acquisition price and, thus, Jefferies' compensation on the trade. He did not purchase the MSM MBS at "m53s" (or mid-53s), but at 53-00. As a result, Jefferies earned 32 ticks on the trade, rather than approximately 16 ticks as agreed.

79. As a result of his misconduct, Litvak made approximately $70,000 more for Jefferies on this trade.

June 17, 2010 Trade with Angelo Gordon

80. On June 17, 2010, Litvak purchased $4.7 million of a MBS called CHL Mortgage Pass-Through Trust 2005-HYB6 2A1 (CWHL 2005-HYB6 2A1) at 62-16. Later that day, Litvak approached a representative at Angelo Gordon in an effort to resell the MBS. Litvak told him that he had bought the MBS at 68-1 and asked, "want em at 68-16?" The representative agreed and Angelo Gordon purchased the CWHL MBS at 68-16.

81. Litvak lied about Jefferies' acquisition price and, thus, Jefferies' compensation. Litvak told Angelo Gordon that he had bought the MBS at 68-1, when in fact he had purchased the MBS at 62-16. As a result, he earned Jefferies 192 ticks on the trade, instead of the agreed-to 15 ticks.

82. As a result of his misconduct, Litvak made over $120,000 more for Jefferies on this trade.

July 1, 2010 Trade with Invesco

83. On July 1, 2010, Litvak sent out a bid list that included a MBS called Structured Adjustable Rate Mortgage Loan Trust, Series 2005-21 7A1 (SARM 2005-21 7A1). (Customers typically send "bid lists" to their brokers to solicit offers on a list of bonds.) A representative from Invesco responded to the list. The representative said that Invesco would bid 79-24 on the MBS. Litvak responded that he would "brb" ("be right back"), to which the representative replied, "thx, got some room too."

84. Litvak then informed Invesco about the results from his bid:

Litvak:	winner bro…he had 2 other guys that were at 79 and trying to improve…but he just sold em to us…I bid your level….so will work for whatever you want big man….
Representative:	wow…that was fast. nice work. 6 ticks cool? 79-30 to me?
Litvak:	ure timing was perfect…3pm bwic and he is good about trading things fast…so we got in there right at the right time…good teamwork…6/32s is great…thanks BN.

85. Litvak lied to the representative that he had "bid" his "level." Jefferies had acquired the security at 79-16, not at Invesco's requested bid of 79-24. Litvak also misled Invesco about the compensation that Jefferies would receive. Invesco purchased $59 million of the MBS at 79-30, and therefore, Litvak received 14 ticks for the trade and not the agreed to "6 ticks."

86. As a result of his misconduct, Litvak made over $70,000 more for Jefferies on this trade.

September 29, 2010 Trade with AllianceBernstein

87. On September 29, 2010, a Jefferies colleague told Litvak that Jefferies had purchased $3.27 million of a MBS called HarborView Mortgage Loan Trust, Series 2007-7 2A1A (HVMLT 2007-7 2A1A) at 65. An hour later, Litvak approached a representative at AllianceBernstein in an effort to sell the MBS. Although he knew that Jefferies had already bought the MBS at 65, Litvak pretended to be arranging a trade for an active outside seller who was offering the MBS at 67:

> small guy just gave me an order on the hvmlt 07-7 2a1a gem… he offered bonds at 67 …. let me know if you guys want to show a level….i havent really got a read on how married to 67 he is . . . .

88. When the representative responded that he would bid 66 for the HVMLT MBS, Litvak pretended to negotiate with the phantom seller and reported back that "he would sell bonds to me 66-16 best…." The representative indicated that he was interested in buying the MBS at 66-16, and ten minutes later, Litvak responded "i bot a lil cheap to 66-16 so we can be done . . . . 66-16 to u." AllianceBernstein purchased the MBS at 66-16.

89. Litvak lied to AllianceBernstein about the acquisition price (which was 65, not "lil cheap to 66-16"), the compensation (which was 48 ticks, not "lil cheap," or a small number of ticks), and the source of the MBS (pretending he was arranging a trade, when he knew Jefferies already owned the bond).

90. Through his misconduct, Litvak made more than $30,000 more for Jefferies on this trade.

November 22, 2010 Trade with Magnetar

91. On November 18, 2010, Jefferies bought $14.262 million of a MBS called First Horizon Alternative Mortgage Securities Trust 2005-AA10 2A1 (FHAMS 2005-AA10 2A1) at 51-8. Four days later, Litvak approached a representative at Magnetar Capital LLC

("Magnetar") about buying the MBS. Although he knew that Jefferies held the MBS in its inventory, Litvak pretended he was arranging a trade with an active seller and told Magnetar that the seller was "offering me bonds at 55."

92. The Magnetar representative said he was interested in the MBS and instructed Litvak to bid 50-16. He asked Litvak what kind of seller was involved, and Litvak replied, "money mngr." Litvak then pretended to negotiate with the phantom seller, reporting back to Magnetar that "he came off 1pt to 54 …..i am getting the sense that he really doesnt want to sell bonds that much lower than that…..based on my last conversation." The Magnetar representative responded, "you tell me – isn't it a low 50s bond?"

93. After some further consideration, the Magnetar representative raised his bid to 52-16, but emphasized to Litvak that "definitely do not want to pay more than what I have to. . . ." Litvak continued his fabricated negotiation, reporting back after 30 minutes, "he is at 53-16 bro….i beat him up pretty good to get that….and think we are getting to the end of the rope with him . . . ."

94. Magnetar then raised its bid to 53. Litvak reported back twenty minutes later that he had bought the MBS at 53, emphasizing how hard he had negotiated with the seller:

> alright dude…he sold me bonds at 53….but it was painful getting him to do it! he literally was talking about bwic'ing them….and i was like dude…u cant…..so whatever the case …..i bot bonds at 53 . . . .

95. After this communication, Magnetar agreed to buy the MBS at 53-8.

96. Litvak lied about the acquisition price (51-8, not "53") and, thus, Jefferies' compensation (64 ticks, not 8 ticks). He also lied about the source of the MBS (pretending he was arranging the trade when Jefferies owned the MBS in its inventory).

97. As a result of this misconduct, Litvak made more than $90,000 more for Jefferies on this trade.

January 7, 2011 Trade with DW Investment and Columbia

98. On January 7, 2011, Litvak lied to both the seller and buyer while arranging the trade of $20 million of a MBS called Bear Stearns Mortgage Funding Trust 2007-AR1 2A4 (BSMF 2007-AR1 2A4) . Columbia Management Investment Advisors, LLC ("Columbia") was seeking to sell the MBS and DW Investment Management, LP ("DW Investment") was seeking to buy the MBS.

99. Litvak lied to Columbia about the price at which he would resell the MBS. After learning that a representative of DW Investment had bid 19 for the MBS, Litvak told a representative at Columbia that the prospective buyer "will pay me 18-26. if u want I will work for 2/32s on this one." Following this exchange, Columbia agreed to pay 2 ticks for the trade and sold the MBS to Jefferies for 18-24.

100. Litvak then used a Jefferies colleague to mislead the DW Investment representative about the acquisition price. After agreeing to buy the MBS from Columbia at 18-24, Litvak told the Jefferies salesperson who was negotiating with DW Investment, "Done. I bot @ 18-24. Just tell [DW Investment] We bot em @ 19-4." The Jefferies salesperson then told the DW Investment representative, "jesse bot em 19-04… pay me what u like on top." DW Investment agreed to purchase the MBS at 19-16.

101. Through his misconduct, Litvak made more than $40,000 more for Jefferies on this trade.

January 11, 2011 Trade with Magnetar

102. On January 11, 2011, Litvak communicated with a representative at Magnetar regarding a MBS called HarborView Mortgage Loan Trust Series 2004-9 4A3 (HVMLT 2004-9 4A3). After learning from a Jefferies colleague that Magnetar could buy the MBS for 60-16,

Litvak told the Magnetar representative, "they are offering me bonds at 61." When Magnetar expressed interest in the MBS, Litvak told the representative, "he is gonna sell me bonds 4/32s cheap to 61….so you can have em at 61 and if your feeling the love anything above that would be great….but like I said….im totally cool at 61 too…." Magnetar agreed to buy $49.3 million of the MBS at 61-4.

103. Litvak lied about the acquisition price and, thus, Jefferies' compensation on the trade. Jefferies bought the MBS for 60-16, not 60-28 (or "4/32s cheap to 61"), as represented. Jefferies earned 20 ticks on the trade, not the 8 ticks agreed to.

104. As a result of this misconduct, Litvak made more than $30,000 more for Jefferies on this trade.

January 26, 2011 and March 28, 2011 Trades with Monarch

105. On January 25, 2011, Jefferies bought $16.05 million of a MBS called Washington Mutual Mortgage Pass-Through Certificates, Series 2005-AR19 A1B3 (WAMU 2005-AR19 A1B3) at a price of 72-4. The next day, January 26th, Litvak approached a representative at Monarch Alternative Capital LP ("Monarch") about the MBS, saying, "im seeing 15mm orig of wamu 05-ar13 a1b3 bro." Litvak pretended to be working with an active seller of the MBS and told the representative that the purported seller had told Litvak "to work em at 76…..i think i can buy these at 75 though…..but below that he might check away." The representative expressed interest in buying the MBS, and Litvak told him that he would "bid him at 74 and try to get em as cheap as i can." Seven minutes later, Litvak told the Monarch representative, "i bot bonds at 74-24." Monarch agreed to buy $15 million of the MBS for 75-8.

106. Litvak misrepresented the acquisition price (which was 72-4, not "74-24") and, thus, Jefferies' compensation (100 ticks, not 16 ticks).

107. On January 26, 2011, Jefferies bought $7.95 million more of WAMU 2005-AR19 A1B3 at 74.

108. On March 28, 2011, Litvak approached a representative at Monarch about purchasing the MBS. Although Jefferies had owned the MBS for over sixty days, Litvak again pretended to be arranging a trade and fabricated a negotiation with a phantom active seller.

109. Litvak told the Monarch representative, "ny guy that owns that ar19 a1b3 is a seller at 77 to me fwiw." The Monarch representative told Litvak he was a "76 bid." Litvak pretended to negotiate with the "ny guy" and told the Monarch representative that he had "bid him 75 and he said nothing to do….but said he would come back with a level off 77." Ten minutes later Litvak reported that "he came back at 76-16 brah." In response, the Monarch representative offered to increase his bid to 75-24, with a total payment of 76-08.

110. The Monarch representative then told Litvak that he could not "pay more than 76-08." Litvak told him that he "understood" and, fifteen minutes later, reported back, "we are good dude…im buying em at 76." Monarch bought $8.91 million of the MBS at 76-8.

111. Litvak misrepresented the acquisition price (74, not "76") and, thus, Jefferies' compensation (74 ticks, not 8 ticks).

112. As a result of his misconduct, Litvak made more than $100,000 more for Jefferies on these two trades.

April 12, 2011 Trades with Soros

113. On April 12, 2011, Litvak communicated with a representative at Soros Fund Management LLC ("Soros") about a MBS called GreenPoint Mortgage Funding Trust 2006-AR3 4A1 (GPMF 2006-AR3 4A1). Soros was interested in buying the MBS, and Litvak told the representative that the seller "wont say where in the 57s…but i don't think we have to be north

of 57-16 as i read the tea leaves." The Soros representative asked Litvak to bid 57-8 for the bonds, and seven minutes later, Litvak reported, "i showed 57-5 and we bot em w/a 57-1 cover! good teamwork." Soros agreed to buy $10.2 million of the MBS at 57-9.

114. Litvak lied about the acquisition price. He had purchased the MBS at 56-10, not the "57-5" he represented. He also lied about Jefferies' compensation. Jefferies earned 31 ticks on the trade, not the 4 ticks agreed upon. Litvak also lied about the second-highest price for the MBS, or "cover."

115. Through his misconduct, Litvak made more than $40,000 more for Jefferies on this trade.

116. Later the same day, Litvak approached the Soros representative about buying more GPMF 2006-AR3 4A1. He first instructed Litvak to bid 56-16. Litvak reported that they were "cover" – that is, the second-highest bid. In response, Soros offered to "go to 56-24." About fifteen minutes later, Litvak told the Soros representative, "bot em there . . . 56-22 cover" and Soros agreed to buy $9.75 million of the MBS at 57.

117. Litvak had lied again about the acquisition price. He bought the MBS at 56-17, not at 56-24, as represented. He also lied about Jefferies' compensation. Jefferies earned 15 ticks on the trade, not the 8 ticks agreed upon. He lied about the cover again, as well.

118. As a result of his misconduct, Litvak made more than $10,000 more for Jefferies on this trade.

June 3, 2011 Trade with Monarch

119. On June 3, 2011, Litvak approached a representative at Monarch about buying a MBS called Bear Stearns Mortgage Funding Trust 2007-AR4 2A1 (BSMF 2007-AR4 2A1).

Litvak told the Monarch representative, "I just bot these h61s." Monarch agreed to purchase $13.25 million of the MBS at 62.

120. Litvak lied to Monarch about the acquisition price and, thus, Jefferies' compensation on the trade. He had actually bought the MBS at 61 and not "h61s" (meaning high 61s).

121. Through his misconduct, Litvak made more than $60,000 more for Jefferies on this trade.

June 22, 2011 Trade with AllianceBernstein

122. On June 22, 2011, Litvak communicated with a representative at AllianceBernstein about a MBS called HVMLT 2007-7 2A1A. Litvak told the representative that he "bot em at 67-21," and that "if you guys want em you can have em….if not….thats ok too. . . ." The AllianceBernstein representative asked if AllianceBernstein could "buy them +4?" (i.e., at purchase price plus four ticks). Litvak responded, "sure…67-25 works for me."

123. AllianceBernstein bought $13.570 million of the MBS at 67-25.

124. The same day, Litvak communicated with a colleague at another firm about the possible trade with AllianceBernstein. Litvak told the person that if he received a bid from AllianceBernstein, "im def gonna be working for something. . . . f this 4-8/32s sht."

125. Litvak misrepresented the acquisition price. Jefferies had bought the MBS at 67-15, not "67-21" as represented. He also lied about Jefferies' compensation. Jefferies earned 10 ticks on the trade, not the "+4" (or 4 ticks) agreed upon.

126. Through his misconduct, Litvak made more than $10,000 more for Jefferies on this trade.

August 11, 2011 and August 15, 2011 Trades with AllianceBernstein

127. On August 11, 2011, Litvak communicated again with a representative at AllianceBernstein concerning a MBS called HarborView Mortgage Loan Trust, Series 2007-4 2A1 (HVMLT 2007-4 2A1). Litvak showed the MBS to the representative, who bid 64 for the MBS.

128. Litvak then suggested to the representative that he should raise his bid because Litvak did not think that the seller would go below 65.

Litvak:	so super full disclosure….other bidder is not going to get higher (he is 64-20) and the cheapest counter i have seen is 65-16….i don't think he sells bonds with a 64h……but i think he sells bond in that 65-8 range
Representative:	If you can get him to 65flat and he pays you…we will buy.
Litvak:	ok
Litvak:	let me go work my magic
Litvak:	bot em at 64-30 …7.7 mm orig
Representative:	Cool. Thx for the trade.

129. AllianceBernstein purchased $7.7 million of the MBS at 65.

130. Litvak lied to AllianceBernstein about the acquisition price. Litvak had purchased the MBS at 64-18, not "64-30" as he told the representative. Litvak also misled AllianceBernstein about the amount of Jefferies' compensation for the trade. AllianceBernstein purchased the MBS for 65, and therefore Jefferies' profit was 14 ticks rather than the 2 ticks AllianceBernstein agreed to.

131. Through his misconduct, Litvak made more than $10,000 more for Jefferies on this trade.

132. Four days later, on August 15, the representative told Jefferies that he was interested in looking at a MBS called IndyMac INDX Mortgage Loan Trust 2006-FLX1 A1

(INDX 2006-FLX1 A1) and suggested bidding at 63-20. After Litvak told the representative that his bid was too low, and something over 65 was required, another AllianceBernstein representative told Litvak the best bid was 65-05.

133. Litvak then purchased the MBS for Jefferies at 65-1.

134. Although he knew Jefferies already bought the MBS at 65-01, Litvak pretended to continue to negotiate with the seller, telling AllianceBernstein, the "account coming back to us asking us if we can pay them 65-16…sounds like the other guy was right in that context…." The representative responded, "we will look at it there," and, sixteen minutes later, Litvak reported, "he sold em to me at 65-14."

135. AllianceBernstein purchased $12.036 million at 65-16.

136. Litvak misrepresented the acquisition price (65-1, not "65-14") and, thus, Jefferies' compensation (15 ticks, not 2 ticks).

137. As a result of his misconduct, Litvak made more than $20,000 more for Jefferies on this trade.

Other Trades

138. In addition to the transactions described above, Litvak engaged in similar misrepresentations of the purchase and sale price of MBS on other occasions, including (but not limited to) on March 22, 2010 with Angelo Gordon; on October 27, 2010 with Angelo Gordon; on June 25, 2010 with Western Asset Management Company; and on January 11, 2011 with DE Shaw & Co, L.P.

139. In total, Litvak's misrepresentations generated over $2.7 million in additional revenue for Jefferies.

140. Jefferies determined Litvak's bonus based on market conditions, firm-wide results, and personal performance. The factors considered when evaluating a trader's personal performance included revenue generation, client impact, and overall contribution to the firm. During the years at issue, Litvak received total discretionary bonuses of $11,783,296.

First Claim for Relief
(Violation of Section 17(a) of Securities Act)

141. The Commission repeats and incorporates by reference the allegations in paragraphs 1 through 140 above as if set forth fully herein.

142. By reason of the foregoing, Litvak, directly or indirectly, acting intentionally, knowingly or recklessly, by use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails, in the offer or sale of securities: (a) employed devices, schemes, or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions to state a material fact necessary to make the statements not misleading; or (c) engaged in transactions, practices, or courses of business which operated as a fraud or deceit upon the purchasers of such securities.

143. By engaging in the conduct described above, Litvak has violated, and unless enjoined will continue to violate, Section 17(a) of the Securities Act [15 U.S.C. §77q(a)].

Second Claim for Relief
(Violation of Section 10(b) of Exchange Act and Rule 10b-5)

144. The Commission repeats and incorporates by reference the allegations in paragraphs 1 through 140 above as if set forth fully herein.

145. By reason of the foregoing, Litvak, directly or indirectly, acting intentionally, knowingly or recklessly, in connection with the purchase or sale of securities, by use of the

means or instrumentalities of interstate commerce or the facilities of a national securities exchange or the mail: (a) employed devices, schemes, or artifices to defraud; (b) made untrue statements of material fact or omitted to state material fact(s) necessary to make the statements made not misleading; or (c) engaged in acts, practices, or courses of business which operated as a fraud or deceit upon certain persons.

146. By engaging in the conduct described above, Litvak has violated, and unless enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5].

PRAYER FOR RELIEF

WHEREFORE, the Commission requests that this Court:

A. Enter a permanent injunction restraining Litvak and each of his agents, servants, employees and attorneys and those persons in active concert or participation with him who receive actual notice of the injunction by personal service or otherwise, including facsimile transmission or overnight delivery service, from directly or indirectly engaging in the conduct described above, or in conduct of similar purport and effect, in violation of Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)]; and Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

B. Require Litvak to disgorge his ill-gotten gains, plus pre-judgment interest;

C. Require Litvak to pay appropriate civil monetary penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Securities Exchange Act [15 U.S.C. § 78u(d)(3)];

D. Retain jurisdiction over this action to implement and carry out the terms of all orders and decrees that may be entered; and

E. Grant such other and further relief as the Court deems just and proper.

JURY DEMAND

The Commission hereby demands a trial by jury on all claims so triable.

Respectfully submitted,

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U.S. SECURITIES AND EXCHANGE
COMMISSION

Dated: January 28 , 2013

U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 22602 / January 29, 2013

***Securities and Exchange Commission v. Jesse C. Litvak*, Civil Action No. 3:13-CV-00132 (District of Connecticut, Complaint filed January 28, 2013)**

SEC CHARGES FORMER JEFFERIES EXECUTIVE WITH DEFRAUDING INVESTORS IN MORTGAGE-BACKED SECURITIES

The Securities and Exchange Commission today charged a former managing director of Jefferies & Co., Inc. (Jefferies), a New York-based broker-dealer, with making misrepresentations and engaging in misleading conduct while he sold mortgage-backed securities (MBS) in the wake of the financial crisis.

The SEC alleges that Jesse Litvak, a senior trader on Jefferies' MBS Desk who worked at Jefferies' office in Stamford, Connecticut, bought and sold MBS from and to his customers. On numerous occasions from 2009 to 2011, Litvak lied to, or otherwise misled, those customers about the price at which Jefferies had purchased the MBS before selling it to another customer and the amount of his firm's compensation for arranging the trades. On some occasions, Litvak also misled his customer into believing that he was arranging a MBS trade between customers, when Litvak really was selling the MBS out of Jefferies' inventory. Litvak also misled customers about how much money they were paying in compensation to Jefferies. The customers included investment funds established by the United States government in the wake of the financial crisis to help support the market for MBS as well as other investment funds, including hedge funds.

According to the SEC's complaint filed in U.S. District Court for the District of Connecticut, Litvak engaged in misconduct on over 25 trades. When Litvak offered his customers MBS, he lied to them about how much Jefferies had paid (or was paying) for the securities. When negotiating the sale of MBS, Litvak often represented to a customer that Jefferies had paid a particular price for the security, and therefore could sell it to the customer at a slightly higher price. In order to negotiate a higher sale price to his customers, Litvak misled them into believing that Jefferies had paid a higher price for the MBS than it actually had. On some occasions, Litvak also pretended to be actively negotiating with an outside party to buy a security that he would then re-sell to his customer. But none of these negotiations were taking place; instead, Litvak fabricated the existence of the seller and every detail about active negotiations with it. In fact, as Litvak knew, Jefferies had purchased these bonds days before and already held them in its inventory.

The SEC's complaint charges Litvak with violating the antifraud provisions of the federal securities laws, particularly Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933. The complaint seeks a final judgment permanently enjoining Litvak from future violations of the above provisions of the federal securities laws, ordering him to disgorge his ill-gotten gains plus prejudgment interest, and order him to pay civil penalties.

The SEC's investigation, which is continuing, has been conducted by Kerry Dakin, James Goldman, Rachel Hershfang, and Kevin Kelcourse in the Boston Regional Office. Mr. Goldman is a member of the Structured and New Products Unit. The SEC's litigation will be led by Ms. Hershfang.

SEC Complaint

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

FILED

GRAND JURY N-12-3

2013 JAN 25 PM 4 46

U.S. DISTRICT COURT
NEW HAVEN, CT.

UNITED STATES OF AMERICA	:	CRIMINAL NO. 3:13CR___ (___)
	:	
v.	:	VIOLATIONS:
	:	15 U.S.C. §§ 78j(b), 78ff [Securities Fraud]
JESSE C. LITVAK	:	18 U.S.C. § 1031 [TARP Fraud]
	:	18 U.S.C. § 1001 [False Statements to the Government]

INDICTMENT

The Grand Jury charges that at all times relevant to this Indictment:

The Defendant

1. Defendant JESSE C. LITVAK, a licensed securities broker, resided in the State of New York and was a senior trader and managing director at Jefferies & Co., Inc. (referred to herein as "Jefferies"). LITVAK was hired by Jefferies on or about April 14, 2008 and was terminated on or about December 21, 2011.

2. Jefferies is a broker-dealer registered with the Securities and Exchange Commission ("SEC") and a Financial Industry Regulatory Authority ("FINRA") member firm. Jefferies is a global securities and investment banking firm, with headquarters in New York. Jefferies also has a trading floor in Stamford, Connecticut where LITVAK and other members of its Mortgage and Asset-Backed Securities Trading group worked.

3. LITVAK specialized in trading certain types of residential mortgage-backed securities ("RMBS"), which are securities within the meaning of the federal securities laws.

The Victim-Customers

4. LITVAK's victims are known by the Grand Jury to have been certain of Jefferies' customers.

5. LITVAK's victim-customers included funds established by the United States Department of Treasury's Legacy Securities Public-Private Investment Program ("PPIP"). PPIP was, and is, a part of the United States Government's Troubled Asset Relief Program ("TARP"), the Government bailout plan created in 2009 in response to the financial crisis.

6. In March 2009, Treasury announced the creation of PPIP, the purpose of which was to purchase certain troubled real estate-related securities, including types of RMBS, from financial institutions to allow those financial institutions to free up capital and extend new credit.

7. Beginning in late 2009, the Government used more than $20 billion of bailout money from TARP to fund Public-Private Investment Funds ("PPIFs"), which would purchase the troubled securities. The Government matched every dollar of private investment in a PPIF with one dollar of equity and two dollars of debt. Thus, 75% of each PPIF's money consists of taxpayer funds disbursed by the Government as part of its bailout plan through TARP.

8. Each PPIF was established and managed by a Legacy Securities PPIP fund manager (a "PPIF Manager") selected by the Department of Treasury. Each PPIF Manager owed fiduciary duties to the investors that contributed money to its PPIF, which was primarily the Government.

9. Each PPIF received between approximately $1.4 billion to $3.7 billion of bailout money.

10. Under the rules of PPIP, a PPIF could buy or sell only certain types of RMBS, including the types of RMBS that LITVAK specialized in.

11. The following six PPIFs are known by the Grand Jury to have been LITVAK's victim-customers (each a "TARP-Funded Victim"):

a. AG GECC PPIF Master Fund, L.P. (PPIF Manager: Angelo, Gordon & Co., LP);

b. AllianceBernstein Legacy Securities Master Fund, L.P. (PPIF Manager: AllianceBernstein, LP);

c. BlackRock PPIF, L.P. (PPIF Manager: BlackRock, Inc.);

d. Invesco Legacy Securities Master Fund, L.P. (PPIF Manager: Invesco Ltd.);

e. RLJ Western Asset Public/Private Master Fund, L.P. (PPIF Manager: RLJ Western Asset Management, LLC); and

f. Wellington Management Legacy Securities PPIF Master Fund, LP (PPIF Manager: Wellington Management Company, LLP).

12. In addition, the following non-PPIP entities or their affiliates, or funds or entities managed by or affiliated with them, are known by the Grand Jury to also have been LITVAK's victim-customers (each a "Privately-Funded Victim"):

a. DE Shaw & Co.;

b. DW Investment Management LP;

c. EBF & Associates;

d. Magnetar Capital;

e. MFA Financial, Inc.;

f. Monarch Alternative Capital;

g. Oak Hill Capital;

h. Pine River Capital Management;

i. Putnam Investments;

j. QVT Financial;

k. Red Top Capital Investments;

l. Soros Fund Management LLC;

m. Third Point LLC; and

n. York Capital Management, LLC.

Other Relevant Persons

13. Supervisor #1 is known by the Grand Jury to have been one of LITVAK's supervisors at Jefferies.

RMBS Trading

14. RMBS are bonds comprised of large pools of residential mortgages and home equity loans. The RMBS owners receive payments on a monthly basis based on repayments from the homeowners that took out the mortgages or loans, until the homeowners repay their debt, refinance or default. Unlike stocks, RMBS bonds are not publicly traded on an exchange, such as the New York Stock Exchange or NASDAQ, and pricing information is not publicly-available. Instead, buyers and sellers of bonds use broker-dealers, like Jefferies, to execute individually negotiated transactions.

15. The unit at Jefferies that handles RMBS trading is known as the Mortgage and Asset-Backed Securities group, which employs traders and salespeople. In general, a trader, like LITVAK, specializes in particular kinds of RMBS or "sectors," while a salesperson is responsible for certain customers or "accounts."

16. RMBS bonds typically are sold in three ways:

a. from a broker-dealer's inventory, in which the broker-dealer like Jefferies is selling a bond that it has owned for a period of time;

b. as an order, in which the seller commissions the broker-dealer to seek a buyer, or the buyer commissions the broker-dealer to seek a seller, for a particular bond; or

c. as part of a "bid list" or "BWIC" ("bids wanted in competition"), in which the seller circulates a list of specific bonds it is interested in selling so that the broker-dealer may seek a potential buyer willing to negotiate terms for the trade.

17. Orders and bid list trades are considered "riskless" trades for broker-dealers like Jefferies because in those transactions broker-dealers merely act as match-makers, serving as a conduit for a bond to pass from a seller to a buyer.

18. In orders and bid list trades, the buyer and the seller do not know each other's identity, but communicate exclusively through the broker-dealer's traders and salespeople.

19. Buyers attempt to purchase bonds at the lowest price available in the market, and sellers try to sell bonds at the highest price available. This is called "best execution." Where a buyer does not obtain best execution, its investment will be less profitable than it would have been otherwise.

20. A broker-dealer's profit, if any, on a set of trades is the difference or "spread" between the price it pays the seller and the price it charges the buyer. In the bond industry, prices are measured in 1/32s of a dollar, commonly referred to as "ticks." For instance, if a broker-dealer buys a bond for $65.25 (meaning $65.25 per $100 of current face value), the price would be expressed as "65 dollars and 8 ticks," "65 and 8" or "65-8." If the broker-dealer then sells that bond for $65.50 (meaning $65.50 per $100 of current face value), the price would be expressed as "65 dollars and 16 ticks," "65 and 16," or "65-16." The broker-dealer's profit on this set of trades would be $0.25 per $100 of current face value, or 8 ticks.

21. A customer can compensate a broker-dealer for a trade in one of two ways, either on an "all-in" or an "on-top" basis.

a. In an "all-in" trade, the buyer agrees to a price without reference to the price the broker-dealer paid to the seller; the spread between the amount paid by the buyer and the amount paid to the seller is the broker-dealer's compensation.

b. In an "on-top" trade, the buyer and the broker-dealer agree on a specific amount that is added to the price the broker-dealer paid to the seller; in other words, the broker-dealer's compensation is a commission added to the cost of the bond.

22. Inventory trades are usually "all-in" transactions, while bid lists are "on top" trades, and orders can be either depending on what the broker-dealer, buyer and seller negotiate.

<u>Jefferies' Codes of Conduct</u>

23. Jefferies maintained (i) a Code of Ethics, (ii) Compliance and Supervisory Policies and Procedures for Mortgage & Asset-Backed Securities Sales and Trading Personnel, and (iii) Compliance and Supervisory Policies and Procedures for Fixed Income Sales and Trading Personnel.

24. In the section entitled "Fair Dealing," Jefferies' Code of Ethics stated that "[t]aking unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair dealing practice is a violation of the Code."

25. Both the Compliance and Supervisory Policies and Procedures for Mortgage & Asset-Backed Securities Sales and Trading Personnel and the Compliance and Supervisory Policies and Procedures for Fixed Income Sales and Trading Personnel include the following statement: "Traders should bear in mind that the anti-fraud provisions of the Exchange Act and

the best execution provisions of FINRA-NASD rules continue to apply to all securities transactions, regardless of the customer's status, and that trading that is suggestive of abuse will not be permitted."

26. Before and during the acts alleged in this Indictment, LITVAK completed acknowledgement forms certifying that he had "read, understood, complied and agree[d] to comply with" these policies.

COUNTS ONE through ELEVEN
Securities Fraud
15 U.S.C. §§ 78j(b), 78ff

The Scheme and Artifice

27. The allegations set forth in paragraphs 1 through 26 of this Indictment are realleged and incorporated as though fully set forth herein.

28. Beginning in approximately 2009 and continuing until approximately December 2011, the precise dates being unknown to the Grand Jury, in the District of Connecticut and elsewhere, LITVAK knowingly and willfully, directly and indirectly, by the use of means and instrumentalities of interstate commerce and of the mails, in connection with the purchase and sale of RMBS, would and did use and employ manipulative and deceptive devices and contrivances in violation of Title 17, Code of Federal Regulations, Section 240.10b-5 by (i) employing devices, schemes and artifices to defraud, (ii) making untrue statements of material facts and omitting to state material facts necessary to make the statements made not misleading in the light of the circumstances under which they were made and (iii) engaging in acts, practices and courses of business which would and did operate as a fraud and deceit on purchasers and sellers of such RMBS.

29. As a result of this scheme, LITVAK caused victim-customers to sustain losses of more than $2,000,000.

Purpose of the Scheme and Artifice

30. A purpose of LITVAK's scheme was to enrich Jefferies and himself by using materially false and fraudulent misrepresentations and omissions to take secret and unearned compensation from TARP-Funded Victims and Privately-Funded Victims on RMBS trades.

31. LITVAK's supervisors at Jefferies, including Supervisor #1, established and communicated specific annual profit goals for the Mortgage and Asset-Backed Securities group. As LITVAK knew, his individual trading revenue was tracked by his supervisors and steadily declined each year—from a profit of more than $40,000,000 in 2009 to a loss of more than $10,000,000 in 2011.

32. LITVAK's scheme increased the profitability of his trades. For example, on or about June 22, 2011, LITVAK corresponded with a trader at another broker-dealer firm about a RMBS bond being offered via a bid list. The approximate "on-top" compensation a broker-dealer can expect on a bid list transaction is between four ticks and eight ticks (between 4/32s and 8/32s per $100 of the bond's current face value). In discussing the price that LITVAK hoped to induce a specific TARP-Funded Victim to pay for this bid list bond, LITVAK wrote "f this 4 - 8/32 sht [*sic*]," to which the other trader responded, "that doesnt feed anyone."

Manner and Means of the Scheme and Artifice

The manner and means by which LITVAK sought to accomplish the scheme included, among others, the following:

33. In certain order and bid list transactions:

a. where the buying victim-customer had agreed upon a specified commission "on top" of the price that Jefferies had negotiated with the seller of a RMBS bond, LITVAK would and did misrepresent to the buyer the price Jefferies had agreed to pay the seller, providing Jefferies with an extra and unearned profit at the buying victim-customer's expense; and

b. where the selling victim-customer had agreed upon a specified commission to be deducted from the price at which Jefferies had negotiated to sell a RMBS bond, LITVAK would and did misrepresent to the seller the price the buyer had agreed to pay to Jefferies, providing Jefferies with an extra and unearned profit at the selling victim-customer's expense.

34. In certain sales of bonds from Jefferies' inventory, LITVAK would and did misrepresent to the buying victim-customer that the transaction was an order or bid list trade requiring "on top" compensation, providing Jefferies with an extra and unearned profit at the buying victim-customer's expense.

35. LITVAK perpetrated this scheme by the use of means and instruments of interstate commerce and the mails in various ways:

a. LITVAK used electronic communications with victim-customers, including telephone, email, instant messages and electronic group "chats," to communicate false statements and misrepresentations with the intent and purpose of soliciting and negotiating fraudulent RMBS bonds trades;

b. LITVAK sent and caused to be sent to victim-customers trade confirmations or tickets documenting fraudulent transactions; and

c. LITVAK caused victim-customers to wire funds to Jefferies, and Jefferies to wire funds to victim-customers, to pay for fraudulent transactions.

Misrepresented Prices

36. It was part of the scheme that LITVAK would defraud victim-customers buying RMBS bonds in bid list and order trades, where the victim-customers agreed to pay Jefferies specific amounts of compensation "on top" of the prices paid to the sellers, by misrepresenting the acquisition costs to be higher than the prices actually paid by Jefferies to the sellers, fraudulently increasing Jefferies' compensation on the transactions.

37. For instance, on or about March 31, 2010, LITVAK executed his scheme in connection with the purchase by the PPIF Manager for the AllianceBernstein Legacy Securities Master Fund, L.P. of two RMBS bonds, HVMLT 2006-10 2A1A (the "HarborView Bond") and LXS 2007-15N 2A1 (the "Lehman Bond"), as follows:

a. On March 31, 2010 at approximately 10:32 a.m., the seller placed an order with Jefferies to sell these two bonds. The seller's offering price at that time was 58 on the HarborView Bond and 57 on the Lehman Bond.

b. At approximately 10:49 a.m., LITVAK approached the PPIF Manager for the AllianceBernstein Legacy Securities Master Fund, L.P. about buying these bonds, writing "wanted to give you first crack on em." The PPIF Manager asked for details, and LITVAK responded by misrepresenting the seller's offering prices as 59 on the HarborView Bond (instead of the actual offering price of 58) and 58-16 on the Lehman Bond (instead of the actual offering price of 57).

c. Between approximately 11:21 a.m. and 11:42 a.m., LITVAK and the PPIF Manager spoke by telephone.

d. At approximately 11:42 a.m., LITVAK electronically communicated with Supervisor #1 as follows:

> alliance just bid me 58 on the 06-10s [the HarborView Bond]....i know he will pay us 4/32s if i tell him we have to pay 58-16.... he also bid us 57-16 on the lxs [the Lehman Bond]....i am thinking of telling him that one has to be 58-8 cuz its one of the bigger ones....

[Ellipses in original.]

e. At approximately 11:48 a.m., Supervisor #1 replied to LITVAK "boom! tell me when to go in." In this context, "tell me when to go in" means when Supervisor #1 should intercede to buy the bonds from the seller.

f. At approximately 12:45 p.m., Supervisor #1 electronically communicated with the seller to confirm Jefferies was buying the HarborView Bond for 57-16 and the Lehman Bond for 56-16. Supervisor #1 then described these prices to LITVAK as "layups."

g. At approximately 12:45 p.m., LITVAK misrepresented the state of negotiations with the seller to the PPIF Manager:

> ok big man....here is what i got from him...i beat him up pretty good.....but this is what he came back with:
> he will sell to me 20mm orig of hvmlt 0610 @ 58-00
> but he is being harder to knock back on the lxs bonds...said that he thinks that one is much cheaper yada yada yada....he told me he would sell them to me at 58-8 (30mm orig)......i would be fine working skinnier on these 2....but think you are getting good levels on these....let me know what you want to do big man....

[Ellipses in original.]

h. At approximately 1:14 p.m., the PPIF Manager responded by inquiring whether these would be "all-in" or "on-top" trades, asking "is he [the seller] paying u or am i?"

i. At approximately 1:21 p.m., LITVAK responded with additional misrepresentations:

> all the levels i put in this [chat]room are levels he wants to sell to me...i tried to beat him up so i could get these levels to you.......but those are the levels he wants to sell to me...i will work for whatever you want on these...

[Ellipses in original.]

j. The PPIF Manager replied back "gonna finish lunch first then re-run it all," and at approximately 1:24 p.m., LITVAK repeated and summarized his earlier misrepresentations:

> sounds good.....so to recap the levels he is offering to me:
> hvmlt 06-10 2a1a (20mm orig) @ 58-00
> lxs 40mm orig at 58-8

[Ellipsis in original.]

k. At approximately 1:45 p.m., LITVAK told the PPIF Manager "bot em," indicating that LITVAK had purchased the HarborView Bond and the Lehman Bond. The PPIF Manager replied by proposing Jefferies not receive any compensation on (or "wash") the smaller HarborView Bond trade and add five ticks as compensation on the Lehman Bond trade. Approximately one minute later, LITVAK responded "thats fine."

38. The AllianceBernstein Legacy Securities Master Fund, L.P. paid approximately $7,000,000 for the HarborView Bond and approximately $20,000,000 for the Lehman Bond.

39. The seller did not offer to sell the HarborView Bond for 59, as LITVAK misrepresented to the PPIF Manager for the AllianceBernstein Legacy Securities Master Fund, L.P. In truth and in fact, as LITVAK knew, the seller's offer was actually 58.

40. The seller did not offer to sell the Lehman Bond for 58-16, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, the seller's offer was actually 57.

41. LITVAK did not communicate to the seller the PPIF Manager's bids made between approximately 11:21 a.m. and 11:42 a.m., as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, all his statements about the seller's reaction to those bids were false.

42. When LITVAK electronically communicated with the PPIF Manager after approximately 12:50 p.m., the seller was no longer seeking 58 for the HarborView Bond or 58-8 for the Lehman Bond, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, the seller had already agreed to accept lower prices.

43. Jefferies did not pay the seller 58 for the HarborView Bond, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, Jefferies paid 57-16.

44. Jefferies did not pay the seller 58-8 for the Lehman Bond, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, Jefferies paid 56-16.

45. Jefferies did not work without compensation on the HarborView Bond trade, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, on this riskless trade, LITVAK took 16 ticks as compensation for Jefferies, or approximately $60,000.

46. Jefferies did not work for five ticks of compensation on the Lehman Bond trade, or approximately $50,000, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, on this riskless trade, LITVAK took 61 ticks as compensation for Jefferies, or approximately $650,000.

Misrepresented Inventory Trades as Orders or Bid List Trades

47. It was further part of the scheme that LITVAK would defraud victim-customers buying RMBS bonds held in Jefferies' inventory by misrepresenting those as orders and bid list trades with compensation for Jefferies "on-top," taking increased and unearned profits because, on inventory transactions, broker-dealers are not entitled to extra compensation in addition to the price paid. By doing this, LITVAK falsely portrayed himself to victim-customers as their ally in negotiations against non-existent sellers, rather than admitting that he was, in fact, negotiating directly against his victim-customers.

48. To effect his scheme, LITVAK would invent a fictitious seller for a bond that Jefferies already had in its inventory and was seeking to sell to a victim-customer. LITVAK would then falsely describe the fictitious seller's offering price and reaction to LITVAK's negotiating tactics.

49. For instance, on or about December 23, 2009, LITVAK executed his scheme in connection with the purchase by the PPIF Manager for the Wellington Management Legacy Securities PPIF Master Fund, LP of the RMBS bond WFMBS 2006-AR12 1A1 (the "Wells Fargo Bond"), as follows:

a. On or about December 14, 2009, LITVAK paid 70 (meaning $70 per $100 of current face value) for the Wells Fargo Bond, with an original face value of $6,230,000, for Jefferies' inventory.

b. On or about December 18, 2009, LITVAK first offered to sell Jefferies' Wells Fargo Bond to the Wellington Management Legacy Securities PPIF Master Fund, LP. LITVAK misrepresented that he had an order from a third party seller, writing "i have a guy that has 6+mm orig of wfmbs 06-ar12 1a1...my guy would sell to me at 77.... [ellipses in original.]"

The PPIF Manager bid 74, and LITVAK responded by describing his communications with the fictitious seller:

> i will reflect that in big man and see what he says….
> at this point…he really wants me to work it longer (i just got the bonds this am to work)….so he actually gave me the ol "just keep working em at 77" rap…..didnt even give me any room off 77…..fck [*sic*]
> he appreciates it…but has some internal conversations about where he told them he can sell it and at 75 he would not be looking good internally is what he said….
> i thought i could work him over…but he is kind of being a weenie

[Ellipses in original.]

c. On or about December 23, 2009 at 7:46 a.m., LITVAK approached the PPIF Manager for the Wellington Management Legacy Securities PPIF Master Fund, LP again, asking for information about another trade and suggesting "maybe i can use that as leverage to go beat the guy up that owns the 06-ar12 1a1 bonds….as of last nite it sounded like he was starting to warm up to the idea of coming off his level [ellipsis in original]."

d. At approximately 7:48 a.m., the PPIF Manager expressed interest, asking "what's the current size and offer on the 06-ar12 1a1 again?" Approximately one minute later, LITVAK responded "it's 3+mm current and he was offering them at 77….. [ellipsis in original.]"

e. At approximately 8:14 a.m., LITVAK updated the PPIF Manager by making further misrepresentations about the fictitious seller, writing "he is still red-dotted….usually rolls in around now…..so should know soon brotha….. [ellipses in original.]" ("Red-dotted" in this context means that the fictitious seller was unavailable to participate in electronic communications.)

f. At approximately 8:46 a.m., LITVAK misrepresented to the PPIF Manager that he had concluded negotiations with the seller at a price that would result in a four-tick profit to Jefferies, writing "winner winner chicken dinner……he is gonna sell em to me at

75-28 as i told him to not get cute and just sell the bonds so you can own them at 76....he said cool..... [ellipses in original.]"

50. The Wellington Management Legacy Securities PPIF Master Fund, LP paid approximately $2,300,000 for the Wells Fargo Bond.

51. LITVAK did not engage in any negotiations or communications with the seller of Wells Fargo Bond on December 23, 2009, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, there was no third party seller, since Jefferies already owned the Wells Fargo Bond.

52. Jefferies did not purchase the Wells Fargo Bond from a third party seller on December 23, 2009, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, Jefferies purchased that bond nine days earlier, on or about December 14, 2009.

53. Jefferies did not pay the seller 75-28 for the Wells Fargo Bond, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, Jefferies paid 70 or approximately $2,100,000.

54. Jefferies' profit on this set of transactions was not four ticks, or approximately $3,800, as LITVAK misrepresented to the PPIF Manager. In truth and in fact, as LITVAK knew, Jefferies's profit was 192 ticks, or approximately $185,000.

The Securities

55. Beginning in approximately 2009 and continuing until approximately December 2011, the precise dates being unknown to the Grand Jury, in the District of Connecticut and elsewhere, Defendant JESSE C. LITVAK knowingly and willfully, directly and indirectly, by the use of means and instrumentalities of interstate commerce and of the mails, in connection with the purchase and sale of securities, to wit, the RMBS set forth below, would and did use and

employ manipulative and deceptive devices and contrivances in violation of Title 17, Code of Federal Regulations, Section 240.10b-5 by (i) employing the aforementioned devices, schemes and artifices to defraud, (ii) making untrue statements of material facts and omitting to state material facts necessary to make the statements made not misleading in the light of the circumstances under which they were made and (iii) engaging in acts, practices and courses of business that would and did operate as a fraud and deceit on purchasers and sellers of such securities as set forth below, each constituting a separate count of this Indictment:

Count	Trade Date	Security
1	3/31/10	HVMLT 2006-10 2A1A (HarborView Bond)
2	3/31/10	LXS 2007-15N 2A1 (Lehman Bond)
3	6/22/11	HVMLT 2007-7 2A1A
4	7/1/10	SARM 2005-21 7A1
5	12/23/09	WFMBS 2006-AR12 1A1 (Wells Fargo Bond)
6	5/28/09	INDX 2007-AR7 2A1
7	12/9/09	NYMT 2005-2 A
8	1/7/10	DLSA 2006-AR1 2A1A
9	3/29/10	CWALT 2006-OA3 1A1
10	4/1/10	LXS 2007-15N 2A1
11	11/22/10	FHAMS 2005-AA10 2A1

All in violation of Title 15, United States Code, Sections 78j(b) and 77ff, and Title 18, United States Code, Section 2.

COUNT TWELVE
TARP Fraud
18 U.S.C. § 1031

56. The allegations set forth in paragraphs 1 through 26 and 28 through 54 of this Indictment are realleged and incorporated as though fully set forth herein.

57. Beginning in approximately December 2009 and continuing until approximately December 2011, in the District of Connecticut and elsewhere, Defendant JESSE C. LITVAK devised a scheme and artifice to defraud the United States and to obtain money and property by means of false and fraudulent pretenses, representations and promises in connection with grants, contracts, subcontracts, subsidies, loans, guarantees, insurance and other forms of Federal assistance—including TARP, an economic stimulus, recovery or rescue plan provided by the Government, and the Government's purchase of troubled assets as defined in the Emergency Economic Stabilization Act of 2008—the value of such Federal assistance, or any constituent part thereof, being in excess of $1,000,000.

58. On or about the following dates, in the District of Connecticut and elsewhere, defendant LITVAK knowingly executed and attempted to execute the aforementioned scheme and artifice with the intent to defraud the United States and to obtain money and property by means of false and fraudulent pretenses, representations and promises in connection with such Federal assistance in the following RMBS bond transactions with a TARP-Funded Victim:

a. the March 31, 2010 sale of the HarborView Bond to AllianceBernstein Legacy Securities Master Fund, L.P.;

b. the March 31, 2010 sale of the Lehman Bond to AllianceBernstein Legacy Securities Master Fund, L.P.;

c. the June 22, 2011 sale of the HVMLT 2007-7 2A1A bond to AllianceBernstein Legacy Securities Master Fund, L.P.;

d. the July 1, 2010 sale of the SARM 2005-21 7A1 bond to Invesco Legacy Securities Master Fund, L.P.; and

e. the December 23, 2009 sale of the Wells Fargo Bond to Wellington Management Legacy Securities PPIF Master Fund, LP.

All in violation of Title 18, United States Code, Sections 1031 and 2.

COUNTS THIRTEEN through SIXTEEN
False Statements to the Government
18 U.S.C. § 1001

59. The allegations set forth in paragraphs 1 through 26 and 28 through 54 of this Indictment are realleged and incorporated as though fully set forth herein.

60. On or about the following dates, in the District of Connecticut and elsewhere, LITVAK, in a matter within the jurisdiction of the United States Department of Treasury, a department and agency of the United States, did knowingly and willfully make and cause to be made a materially false, fictitious, and fraudulent statement and representation to a PPIF Manager for a TARP-Funded Victim, each statement set forth below constituting a separate count of this Indictment:

Count	Date of Statement	Recipient	False Statement	Correct Fact
13	3/31/10	Trader at PPIF Manager for AllianceBernstein Legacy Securities Master Fund, L.P.	"[S]o to recap the levels he is offering to me: hvmlt 06-10 2a1a (20mm orig) [the HarborView Bond] @ 58-00."	Jefferies had already negotiated with the seller to purchase the HarborView Bond at 57-16.
14	3/31/10	Trader at PPIF Manager for AllianceBernstein Legacy Securities Master Fund, L.P.	"[S]o to recap the levels he is offering to me: ... lxs 40mm orig [the Lehman Bond] at 58-8."	Jefferies had already negotiated with the seller to purchase the Lehman Bond at 56-16.
15	12/23/09	Trader at PPIF Manager for Wellington Management Legacy Securities PPIF Master Fund, LP	"[H]e is gonna sell em to me at 75-28 as i told him to not get cute and just sell the bonds so you can own them [the Wells Fargo Bond] at 76....he said cool."	Jefferies had actually purchased the Wells Fargo Bond in question on December 14, 2009 at 70.
16	6/24/10	Trader at PPIF Manager for Invesco Legacy Securities Master Fund, L.P.	In electronic chat between LITVAK and seller forwarded to trader at PPIF Manager for Invesco Legacy Securities Master Fund, L.P., LITVAK altered chat in original message to show Jefferies' purchase price of "79-26."	In original electronic chat between LITVAK and seller, chat reflected Jefferies' actual purchase price of 79-24.

All in violation of Title 18, United States Code, Sections 1001 and 2.

A TRUE BILL

/s/

FOREPERSON

UNITED STATES OF AMERICA

/s/ David B. Fein

DAVID B. FEIN
UNITED STATES ATTORNEY

/s/ Jonathan N. Francis

JONATHAN N. FRANCIS
ASSISTANT UNITED STATES ATTORNEY

/s/ Eric J. Glover

ERIC J. GLOVER
ASSISTANT UNITED STATES ATTORNEY

Morgan Lewis

Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

E.U. AIFMD, U.S. JOBS Act and Current U.S. Tax Issues

Ethan W. Johnson

William J.G. Yonge

Richard S. Zarin

May 2, 2013

Introduction to Alternative Investment Fund Managers Directive 2011/61/EU ("AIFMD")

Key EU events

Date	Event
21 July 2011	AIFMD came into force
19 December 2012	European Commission adopted a Level 2 Regulation[1] supplementing AIFMD on exemptions, general operating conditions, depositaries, leverage, transparency and supervision
11 February 2013	ESMA published final guidelines for sound remuneration policies under AIFMD

1 Commission Delegated Regulation (EU) No 231/2013 of 19.12.2012

Introduction to AIFMD (continued)

Key EU events

Date	Event
27 March 2013	European Commission published Q&A on application of AIFMD
2 April 2013	ESMA published final regulatory technical standards on types of AIFMs
Q3 2013	ESMA expects to begin implementation of third country chapter of AIFMD
22 July 2013	Deadline for transposition of AIFMD into local law by member states
Q4 2013	ESMA expects to publish regulatory technical standards, advice, guidelines and Q&A on AIFMD

Introduction to AIFMD (continued)

Key EU events

Date	Event
22 July 2014	Transitional period for AIFMs existing prior to 22 July 2013 expires
2015	ESMA due to report on functioning of passport system for EU AIFs and AIFMs, national private placement regimes (NPPRs) and possible extension of passport system to non-EU AIFs and non-EU AIFMs
2015	Commission due to adopt implementing legislation, based on ESMA's report, specifying the date when passports for non-EU AIFs and non-EU AIFMs will be available

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Introduction to AIFMD (continued)

Key EU events

Date	Event
2018	ESMA due to publish a second report on functioning of passport and possible end of NPPRs
2018	Commission due to adopt further implementing legislation, based on ESMA's report, specifying date when NPPRs must be terminated

What Does AIFMD Achieve?

- AIF sector in EU has about €2.2 trillion, more than two thirds held by institutional investors, 70% of which are pension funds or insurance companies[2]
- AIFMD introduces harmonised requirements for firms managing alternative investment funds (AIFs) marketed to professional investors[3] in EU
- AIFMD covers a wide range of AIFs[4] and their managers (AIFMs): equity, private equity, hedge, real estate, infrastructure, wine and art funds

2 Explanatory memorandum to Commission Delegated Regulation (EU) No 231/2013 of 19.12.2012

3 An investor considered to be a professional client or who may, on request, be treated as such within the meaning of Annex II to Directive 2004/39/EC, known as MIFID

4 An AIF is a"collective investment undertaking" which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors, whether open or closed-ended and regardless of its legal structure, excluding funds which are authorised under the EU UCITS Directive. Holding companies, pension funds, certain supranational institutions, national central banks, employee participation or saving plans and securitisation special purpose entities are excluded from the definition. The definition may potentially capture co-investment transactions or similar arrangements, however, depending on their structure and economic terms.

What Does AIFMD Achieve? (continued)

- To obtain authorisation an AIFM[5] must comply with the requirements of AIFMD ranging across operating conditions, organizational requirements, capital, valuation, delegation, leverage, appointment of a single depositary, disclosure to investors and reporting to regulators
- AIFMD provides a marketing and managing passport to authorised EU AIFMs
- Passport may be given to non-EU AIFMs re EU and non-EU AIFs in 2015

5 An AIFM is a legal person whose regular business is managing one or more AIFs. An AIFM is the entity that is, at a minimum, responsible for the portfolio management and risk management of an AIF; each AIF may only have a single AIFM; and an AIFM is not permitted to delegate its tasks to the extent that it would be considered to be a “letter box” entity.

Application of AIFMD

- AIFMD applies to:
  - EU AIFMs which manage[6] one or more AIFs, irrespective of AIF's domicile
  - EU AIFMs which market[7] AIFs to EU professional investors
  - non-EU AIFMs which manage EU AIFs (from 2015)
  - non-EU AIFMs which market AIFs to EU professional investors

6 "managing AIFs" means performing at least portfolio management or risk management

7 "marketing" means "a direct or indirect offering at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union"

Application of AIFMD (continued)

- EU AIFMs will be subject to the full rigour of AIFMD from 22 July 2013, subject to a transitional regime for AIFMs existing before 22 July 2013 who have until 22 July 2014 to apply for authorisation under AIFMD
- EU AIFMs may only market EU AIFs in EU using the passport from 22 July 2013
- EU AIFMs may market non-EU AIFs in EU under NPPRs until at least 2018 and may be given a passport in 2015
- Non-EU AIFMs managing a non-EU AIF and not marketing it in EU are not subject to AIFMD at all

Non-EU AIFMs Must Comply with AIFMD

- Non-EU AIFMs may continue to market AIFs in EU under NPPRs from 22 July 2013 to at least 2018 provided:
  - they comply with AIFMD transparency requirements (see below) for annual reports, disclosure to investors and reporting to regulators
  - where they acquire “control” of an unlisted or listed EU company, they comply with the private equity provisions (see below)
  - cooperation agreements for systemic risk oversight exist between the regulators of the states in which marketing is to occur, the third country of non-EU AIFM and the third country of non-EU AIF

Non-EU AIFMs Must Comply with AIFMD (continued)

  - neither the third country of the non-EU AIFM nor AIF is listed as "non-cooperative" by FATF

- However, member states have discretion to impose stricter rules
  - Non-EU AIFMs may be given a passport to market AIFs to EU professional investors in 2015. If so, a non-EU AIFM who wishes to use the passport will require to be authorised under AIFMD in its chosen member state of reference and comply fully with AIFMD re EU business
  - A non-EU AIFM which manages an EU AIF will require to be authorised under AIFMD in its chosen member state of reference in 2015, whether or not it markets to EU

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Non-EU AIFMs Must Comply with AIFMD (continued)

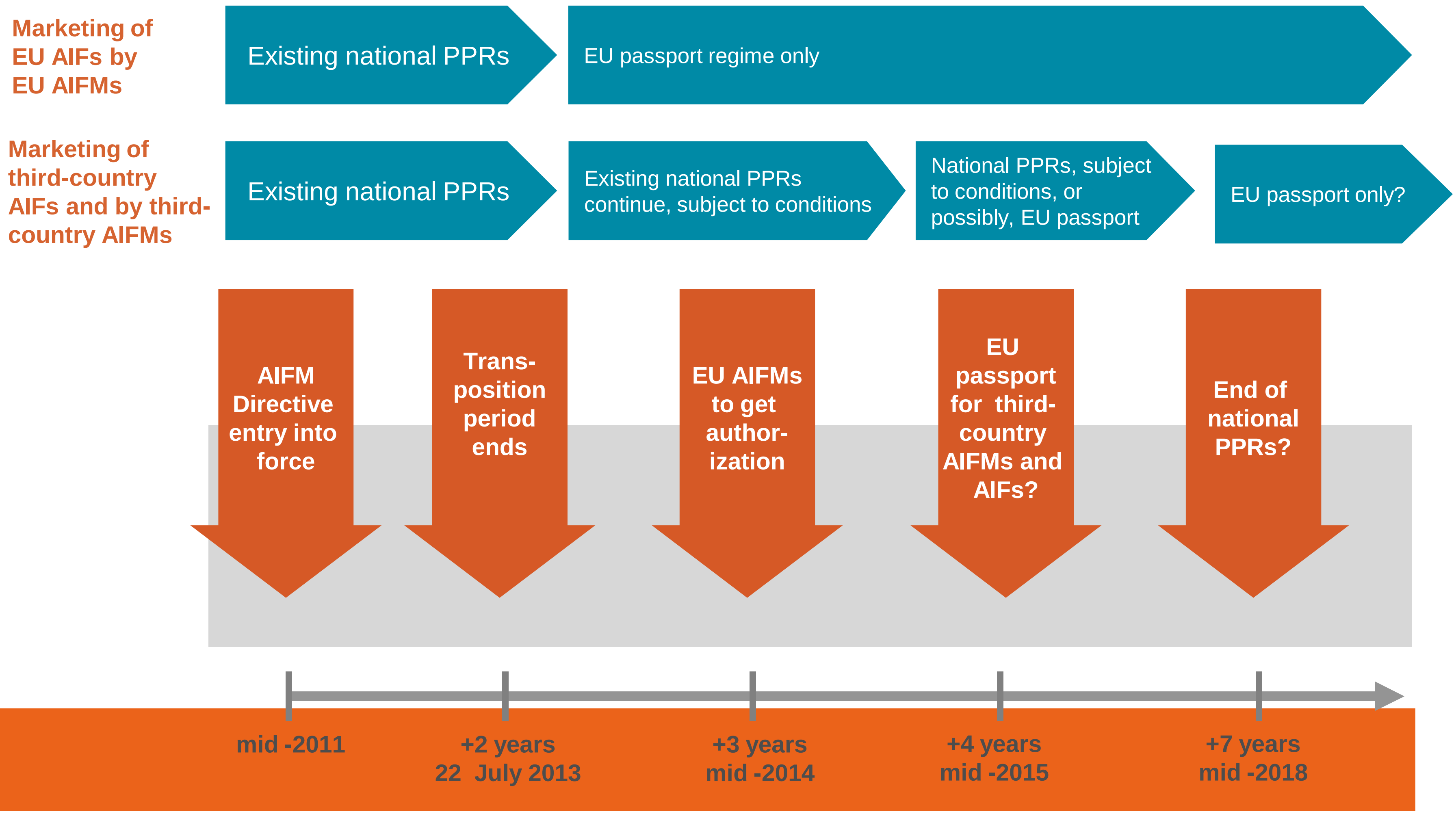
- NPPRs may be abolished in 2018, leaving only the passport route to marketing AIFs to EU professional investors for all AIFMs, both EU and non-EU

AIFMD Cooperation Arrangements between EU (by ESMA) and Third Countries

Third Country (Date)	Exchange of Information	Cross-Border On-Site Visits	Mutual Assistance in the Enforcement of the Respective Supervisory Laws	Applies to Third Country AIFMs that Manage or Market AIFs in the EU	Applies to EU AIFMs that Manage or Market AIFs in the Third Country	Covers Cooperation in the Cross-Border Supervision of Depositaries and AIFMs' Delegates
Switzerland (12/3/12)	X	X	X	X	X	X
Brazil (1/16/13)	X	X	X	X	X	

Note: We understand from the U.S. SEC that it is currently drafting written cooperation arrangements in coordination with ESMA and expects the process to have been completed by end of May 2013

AIFMD Implementation



Implementation of AIFMD in UK

Status of UK transposition

Date	Event
23 January 2012	FSA[8] publishes Discussion Paper
March 2012	HM Treasury published discussion paper “Policy options for implementing AIFMD”
November 2012	FSA published AIFMD Consultation Paper Part 1
January 2013	HM Treasury published consultation paper “Transposition of AIFMD”
March 2013	HM Treasury published a second consultation paper on transposition of AIFMD

8 FSA was succeeded by the Financial Conduct Authority “FCA” and the Prudential Regulation Authority on 1 April 2013. FCA is the relevant UK regulator for AIFMD purposes.

Implementation of AIFMD in UK (continued)

Status of UK transposition

Date	Event
March 2013	FSA published AIFMD Consultation Paper Part 2
29 April 2013	HM Treasury publish Q&A on UK transposition of AIFMD
May 2013	FCA expected to publish AIFMD Consultation Paper Part 3
Week of 6 May 2013	Treasury expected to publish Policy Statement following its consultation
17 May 2013	HM Treasury/FCA Town Hall on AIFMD, Guildhall, City of London
June 2013	FCA expected to publish Policy Statement containing final approach and handbook text covering Parts 1 and 2 of its consultation

Implementation of AIFMD in UK (continued)

- UK government must transpose AIFMD into national law by 22 July 2013
- Partial implementation by EU regulations directly applicable in UK
- Majority of AIFMD provisions, particularly those applicable to AIFMs, to be implemented via rules of the Financial Conduct Authority ("FCA") which succeeded FSA on 1 April 2013
- UK government regulations will be used to amend primary and secondary legislation and supplement FCA's powers as regulator of AIFMs

Implementation of AIFMD in UK (continued)

- AIFMD allows member states to impose stricter requirements for private placement, additional to those mandated under AIFMD. UK government does not propose to impose additional requirements for third country AIFMs of third country AIFs above the AIFMD minimum
- AIFMD allows member states to establish a de minimis registration regime for AIFMs managing AIFs with assets under management below certain thresholds, so-called "small AIFMs,"[9] and allows them to impose additional requirements

9 AIFMs which manage AIFs whose assets under management (a) including any acquired through use of leverage do not exceed EUR100 million or (b) do not exceed EUR500 million when the AIFs are unleveraged and have no redemption rights exercisable for 5 years from date of initial investment in each AIF

Implementation of AIFMD in UK (continued)

- In context of private placement, UK government will allow EU and third country small AIFMs to market AIFs into UK subject to registration of the AIF with FCA and disclosure obligations to FCA[10]
- UK government proposes not to apply the “private equity provisions” (see below) to small AIFMs “in order to support a competitive market for private equity AIFMs”

10 The small AIFM must provide FCA with such information that FCA directs on the main instruments in which the AIFM trades and the principal exposures and most important concentrations of the AIFs that it manages.

UK Regime Governing Marketing by Non-EU AIFMs of AIFs into the UK

- The draft UK Alternative Investment Fund Managers Regulations 2013 (the UK Regulations)
- Reg 48 – a person "must not market an AIF to an investor domiciled or with a registered office in the UK" unless allowed to do so by the UK Regulations
- Contravention results in the same penalties as a breach of the financial promotion regime and therefore:
  - when done by an unauthorised person, is an offence which will result in the unenforceability of investor agreements
  - when done by an authorised person, may result in an action for damages

UK Regime Governing Marketing by Non-EU AIFMs of AIFs into the UK (continued)

- Reg 51 - an AIFM described in an entry in column A of the table below, or a person acting on its behalf, may market an AIF described in the entry in column B to a professional investor in the UK if the AIF is managed by the AIFM and the condition in column C in the same row of the table is satisfied

A – AIFM	B – AIF	C – Condition
Small Third Country AIFM	UK AIF, EEA AIF or third country AIF	FCA has approved marketing of the AIF in accordance with reg 59 and the AIF continues to be entered on the relevant register
Third Country AIFM that is not a Small Third Country AIFM (a "TC AIFM")	UK AIF, EEA AIF or third country AIF	FCA has approved marketing of the AIF in accordance with reg 60 and the AIF continues to be entered on the Article 42 register

Marketing AIFs Managed by Small Third Country AIFMs into the UK

- Reg 59 - FCA must approve an AIF for marketing in the UK, on application by the AIFM which manages the AIF if it appears to the FCA that:
  - the AIF has a single AIFM
  - the AIFM is a legal person
  - the AIFM is a small third country AIFM
- Once approved, the AIF will be entered on a register maintained by FCA of AIFs managed by small third country AIFMs which have been approved by FCA for marketing in the UK

Marketing AIFs Managed by Small Third Country AIFMs into the UK (continued)

- The small third country AIFM of an AIF on such register must provide FCA with such information as the FCA directs on:
  - the main instruments in which the AIFM trades, and
  - the principal exposures and most important concentrations of the AIFs that it manages in order to enable the FCA to monitor systemic risk effectively

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Marketing AIFs Managed by TC AIFMs into the UK

- Reg 60 - FCA must approve an AIF for marketing in the UK if it appears to FCA that the following conditions are met:
  - the AIF has a single AIFM
  - the AIFM is a legal person
  - the AIFM complies with the transparency requirements under AIFMD in relation to the AIF for which approval is sought
  - if applicable, the AIFM complies with the private equity provisions under AIFMD in relation to the AIF

Marketing AIFs Managed by TC AIFMs into the UK (continued)

– written cooperation arrangements for systemic risk oversight are in place between FCA and the supervisory authorities where the TC AIFM is established and, if applicable, the third country where the AIF is established

– the country where the TC AIFM or, if applicable, the third country AIF is established is not listed as a non-cooperative Country and Territory by FATF

- Once approved, the AIF will be entered on the Article 42 register maintained by FCA of AIFs managed by TC AIFMs which have been approved by FCA for marketing in the UK

Process Regarding Applications to FCA for Consent

- Reg 62(1) - FCA has 20 working days to determine an application for entry on a relevant register
- FCA may refuse and applicant may appeal
- FCA may revoke the registration if it appears to FCA that:
  - the AIFM has contravened any relevant provisions
  - the AIFM has knowingly or recklessly given FCA false or misleading information
  - one or more of the conditions for making the entry in the register is no longer met
  - the AIFM of the AIF applies for, or consents to, the revocation
  - the AIF is wound up

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Process Regarding Applications to FCA for Consent (continued)

- The AIFM may appeal against a proposal by FCA to revoke the registration of an AIF
- FCA may also suspend a register entry in any of the above circumstances and where it considers that the AIFM is likely to contravene the relevant provisions

What Constitutes “Marketing”?

- Article 4(1)(x) of AIFMD defines “marketing” to mean “a direct or indirect offering at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union”
- Under the UK Regulations “a person markets an AIF when the person makes a direct or indirect offering or placement of units or shares of an AIF”

What Constitutes “Marketing”? (continued)

- FCA draft guidance states that a person “offers” or “places” when the person makes a unit or share of an AIF available for purchase by a potential investor
- Any promotion by an unauthorised person of an AIF in the UK must comply with s.21 of Financial Services and Markets Act 2000 (FSMA) whether the promotion constitutes “marketing” or not

Reverse Solicitation or Passive Investment

- AIFMD does not affect the current situation, whereby a professional investor established in EU may invest in AIFs on its own initiative. This has been labelled "reverse solicitation" and "passive marketing"
- Under Reg 50, a person (including the AIFM of the AIF or a person acting on its behalf) may market an AIF to an investor if:
  - the marketing is not at the initiative of the person;

Reverse Solicitation or Passive Investment (continued)

  - that person is able to make a financial promotion of the AIF to that investor under FSMA
- That person has an automatic right to market an AIF and is not obliged to obtain FCA consent
- FCA draft guidance reads:
  - "In determining whether the marketing is at the initiative of the investor, consideration needs to be given to the course of communication or relationship between the investor and those involved with, or connected to, the AIFM or the AIF. Only communications which are solicited by the investor should be considered to have occurred at the initiative of the investor"

Reverse Solicitation or Passive Investment (continued)

- "Communications which are sent to investors as part of an organised marketing campaign or documentation which is available on a publically accessible website should not be considered to be sent at the initiative of the investor"
- "Communications in response to an approach from a potential investor with prior knowledge of the AIF and no previous involvement with the AIFM could be regarded as at the initiative of the investor"

Marketing by a Person other than an AIFM or a Person Acting on its Behalf

- Where consent is required from the FCA for an AIFM (or a person acting on its behalf) to market an AIF under reg 51, a person other than the AIFM or a person acting on its behalf, such as a distributor, is allowed to market the AIF in accordance with Reg 53:
  - if the AIFM which manages the AIF is allowed to market the AIF to a professional investor under Reg 51;
  - the person is able to make a financial promotion to that investor

Marketing by a person other than an AIFM or a Person Acting on its Behalf (continued)

- A person other than the AIFM or a person acting on its behalf may also be allowed to market an AIF in accordance with:
  - Reg 49 (marketing by certain categories of small AIFMs)
  - Reg 50 (passive marketing)

UK Transitional Provision

- On 29 April 2013 HM Treasury announced a significant change in its approach to implementation of the transitional provision in Article 61 of AIFMD (the TP)
- Contrary to the wording of the current draft UK Regulations which applies the TP solely to UK AIFMs existing before 22 July 2013:
  - existing non-UK EEA AIFMs will be able to rely on the TP
  - existing non-EEA or third country AIFMs will be able to rely on the TP

UK Transitional Provision (continued)

- HM Treasury confirm that the TP does apply to the marketing of AIFs managed by transitional AIFMs
- A US TC AIFM managing an AIF before 22 July 2013 would be able to rely on the TP to market the AIF after that date into the UK for up to 12 months, without any requirement for compliance with Reg 60 and admission of the AIF to the Article 42 register
- Similarly, re a small third country AIFM

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Transparency Requirements: Overview

- The transparency requirements of AIFMD comprise pre-sale and post-sale disclosure to investors, an annual report for each AIF and reporting to the competent authority of the EU member states in which they wish to market

Transparency Requirements: Investor Disclosure

- Before an investor invests in a non-EU AIF which an AIFM wishes to market in the EU, the following information must be provided to it, as well as any material changes relating to the information:
  - a description of the investment strategy and objectives, including information on the use, type and source of leverage and the associated risks;

Transparency Requirements: Investor Disclosure (continued)

– a description of any delegated management function;

– a description of the liquidity risk management of the AIF and any existing redemption arrangements with investors;

– a description of all fees, charges and expenses borne (directly or indirectly) by investors;

– a description of any preferential treatment given to any investors; and

– the latest net asset value

Transparency Requirements: Investor Disclosure (continued)

- In addition to the above disclosure, each AIFM must periodically disclose the following information to investors:
  - the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
  - any new arrangements for managing the liquidity of the AIF;
  - the current risk profile of the AIF and risk management systems employed by the AIFM; and

Transparency Requirements: Investor Disclosure (continued)

– in relation to AIFs employing leverage, the AIFM must disclose on a regular basis the maximum level of leverage permitted (as well as any right of re-use of collateral or any guarantee granted under the leveraging arrangement) and the total amount of leverage employed by the AIF

Transparency Requirements: Annual Reports

- For each non-EU AIF marketed in the EU, the AIFM is required to produce an annual report no later than six months following the end of each financial year. The annual report is required to be provided to investors upon request and should be made available to the competent authorities of the EU member states in which the AIF is marketed
- The report is required to include:
  - audited accounting information;

Transparency Requirements: Annual Reports (continued)

- a report on the activities of the financial year;
- the remuneration for the financial year paid by the AIFM to its staff, number of beneficiaries and, where relevant, carried interest paid by the AIF; and
- aggregate remuneration broken down by senior management and members of staff of the AIFM who play a material role regarding the risk profile of the AIF

Transparency Requirements: Annual Reports (continued)

- The European Commission has provided further guidance which:
  - sets out detailed requirements for the content and format of the balance sheet or statement of assets and liabilities and of the income and expenditure account;
  - sets out the requirements of the report on the activities of the financial year;
  - explains what is meant by material changes in the context of Article 22 of AIFMD; and
  - sets out the requirements for the remuneration disclosure

Transparency Requirements: Reporting to Competent Authorities

- An AIFM must provide to each competent authority of the EU member states into which it markets AIFs, information on: the main instruments in which it is trading; the markets of which it is a member or where it actively trades; and the principal exposures and most important concentrations of each of the AIFs it markets in that member state
- On a regular basis

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Transparency Requirements: Reporting to Competent Authorities (continued)

- The AIFM must also provide the following information to the competent authority of the relevant member states:
  - the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
  - new arrangements for managing the liquidity of the AIF;
  - the current risk profile of the AIF and the risk management systems employed by the AIFM;
  - the main categories of assets in which the AIF invested; and the results of the required stress tests

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Transparency Requirements: Reporting to Competent Authorities (continued)

- An AIFM managing funds employing leverage on a substantial basis must also make available:
  - information on the overall level of leverage employed by each AIF;
  - a breakdown between leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives;
  - the extent to which the AIF's assets have been reused under leveraging arrangements;

Transparency Requirements: Reporting to Competent Authorities (continued)

  - the identity of the five largest sources of borrowed cash or securities for each AIF; and
  - the amounts of leverage received from each of those sources
- In addition, the competent authorities may request:
  - the annual report of each AIF;
  - a list of all AIFs the AIFM manages (and markets into the EU) for the end of each quarter; and
  - additional information for the monitoring of systemic risk on a periodic as well as on an ad hoc basis

Private Equity Provisions: AIFMs Managing AIFs which Acquire Control of Unlisted and Listed Companies

- Notification of an interest in an EU unlisted company
  - When an AIF acquires/disposes of shares in an EU unlisted portfolio company (other than an SME[11]), AIFM must notify its regulator of the proportion of voting rights held by AIF when it reaches, exceeds or falls below 10%, 20%, 30%, 50% and 75%

11 SMEs are companies which employ fewer than 250 persons and which have an annual turnover not exceeding EUR50 million, and/or an annual balance sheet not exceeding EUR43 million

Private Equity Provisions: AIFMs Managing AIFs which Acquire Control of Unlisted and Listed Companies (continued)

- Notification on acquisition of control of an EU company
  - In the case of an unlisted company, an AIF (or combination of AIFs) will have "control" if they have more than 50% of the voting rights
  - In the case of a listed company traded on an EU regulated market, "control" is defined by reference to the way in which member states define it (varies from 25% to 66%)

Private Equity Provisions: AIFMs Managing AIFs which Acquire Control of Unlisted and Listed Companies (continued)

- AIFM must notify acquisition of control of an unlisted company to:
  - the company
  - those shareholders whose identities and addresses are or can be made available to the AIFM
  - the regulator of the AIFM

Private Equity Provisions: AIFMs Managing AIFs which Acquire Control of Unlisted and Listed Companies (continued)

- In respect of listed and unlisted companies, AIFM must notify to the same people the:
  - identity of the AIFM which individually or in agreement with other AIFMs manage(s) the AIF that has/have acquired control
  - policy for “preventing and managing conflicts of interest, in particular between AIFM, AIF and the company”
  - policy for external and internal communication to the company, in particular re employees

Private Equity Provisions: AIFMs Managing AIFs which Acquire Control of Unlisted and Listed Companies (continued)

- Notification of future intentions
  – where control is acquired of an unlisted company, AIFM must disclose "its intentions with regard to the future business" of the company and the "likely repercussions on employment" to the company and its shareholders
  – AIFM must request the directors to pass on information to employees or their representatives

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Private Equity Provisions: AIFMs Managing AIFs which Acquire Control of Unlisted and Listed Companies (continued)

- Annual reports
- In case of an unlisted company (other than an SME or a real estate SPV), controlled by an AIF or AIFs, AIFM must ensure prescribed information is disclosed either in the company's annual report or in the AIF's annual report
- The information includes:
  - a fair review of the development of the company's business
  - important events since end of financial year
  - company's likely future development
  - certain information re any acquisitions of its own shares by the company

Private Equity Provisions: “Asset Stripping”

- Broadly, the Article 30 restrictions to prevent “asset stripping” by private equity owners could, depending on member state implementation, impose restrictions on distributions, capital reductions, share redemptions or purchases of own shares by controlled listed and unlisted companies during the first two years of ownership by AIF
- Exclusion for SMEs and real estate SPVs

JOBS Act

- On August 29, 2012, the SEC issued proposed amendments to Rule 506 of Regulation D providing a supplementary private offering procedure that would permit general solicitation and advertising in U.S. private offerings under certain circumstances. The proposed rule would be referred to as Rule 506(c).
- Currently, a fund will lose its exemptions under the Investment Company Act and the Securities Act if it engages in general solicitation in connection with a U.S. private offering. These limitations would continue to apply to traditional private placements under Rule 506(b) of Regulation D where the issuers do not wish to comply with the conditions of proposed Rule 506(c).

JOBS Act – Verification Factors

- Proposed Rule 506(c) would require that (a) each investor be (or the fund reasonably believe the investor to be) an "accredited investor" and (b) the fund take reasonable steps to verify that each investor is an accredited investor. Thus, funds could not sell to non accredited investors under this proposed rule.

- The SEC did not require any specific methods of verification.

JOBS Act – Verification Factors (continued)

- The SEC provided examples of factors to consider:
  - the nature of the investor and the type of accredited investor it claims to be;
  - the amount and type of information the fund has about the investor; and
  - the nature and terms of the offering, such as the minimum investment amount.
- Detailed records of the verification process will have to be maintained by the fund.

JOBS Act – Verification Factors (continued)

- Verification is more challenging with regard to natural persons than with institutions, and the SEC acknowledged that taking reasonable steps to verify such persons' accredited investor status poses practical difficulties.

- The SEC was unwilling to bless verification based solely on investor representations. The SEC stated, "[W]e do not believe that an issuer would have taken reasonable steps to verify accredited investor status if it required only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status."

JOBS Act – Verification Sources

- The SEC listed possible sources of verification:
  - Publicly available information, for example:
    - *If the natural person is a named executive officer of a public company, proxy statement disclosure of the person's compensation.*
  - Third-party information providing "reasonably reliable evidence," such as the following:
    - *For a natural person, copies of the person's Form W-2.*
    - *Industry and trade publications if the natural person works in a field where average annual compensation is disclosed.*
  - Verification by a third party, such as a broker-dealer, attorney, or accountant.
  - Unclear how to establish that a person has a reasonable expectation of reaching the same level of income in the current year.

JOBS Act – Investment Funds

- The Section 3(c)(1) and 3(c)(7) exemptions under the Investment Company Act apply only to funds that are not making and do not “presently” or “at that time” propose to make a public offering of their securities in the US.
- For privately offered funds that wish to rely on the proposed Rule 506(c), a question arose as to whether the use of general solicitation under Rule 506(c) would constitute a public offering. The SEC indicated that offerings in compliance with Rule 506(c) would not be considered public offerings for the purposes of the Investment Company Act exemptions.

JOBS Act – Pending Issues

- Will general solicitations permitted under proposed Rule 506(c) nonetheless be considered public marketing by the CFTC and thus prohibit fund managers from relying on certain CFTC exemptions? The CFTC has informally said that they will follow the SEC Guidance.
- Will general solicitations permitted under proposed Rule 506(c) be considered public solicitations under state blue-sky laws, thus prohibiting funds from using state registration exemptions?
- When will the SEC adopt proposed Rule 506(c)? The SEC is unlikely to lift the general solicitation ban until other protections are in place. For example, the SEC Staff has informally said that proposed Rule 506(c) will not be adopted until they are ready to adopt the "Bad Actor" amendments to Rule 506 that were mandated by Dodd-Frank and proposed by the SEC in 2011, but never adopted.

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US Tax Update

- FATCA
- FBAR
- Federal tax legislation
  – American Taxpayer Relief Act of 2012
  – Financial Products Tax Reform Discussion Draft
  – Financial Transaction Tax Proposal
  – Carried Interest and Enterprise Value Tax Proposal

Foreign Account Tax Compliance Act ("FATCA")

- What is FATCA?
  - FATCA aims to identify U.S. persons earning income through the use of foreign entities
- How does it attempt to accomplish this?
  - FATCA imposes new documentation, withholding and reporting requirements on Foreign Financial Institutions (FFIs), Non-Financial Foreign Entities (NFFEs), and all US withholding agents (USWAs)
  - FATCA imposes a 30% withholding tax on payments made to non-compliant entities and persons. Failure to withhold transfers the liability to the payor

FATCA (continued)

- What does all of this mean for an Asset Manager?
  - FATCA requires US Funds (as USWAs) and non-US Funds (FFIs) to document and perform due diligence on investors and to withhold 30% when required
  - US Funds
    - *No agreement required but will need to perform FATCA due diligence, withholding, if required, and year-end reporting starting on 1/1/14*
  - Non-US Funds
    - *Will very likely meet the definition of FFI and therefore will need to become a participating FFI (PFFI)*
    - *Non-US Funds may be able to mitigate FATCA's impact by obtaining deemed compliant status, or be covered by an Intergovernmental Agreement*
  - Non-US Management Companies
    - *Will very likely be FFIs and will need to register as a PFFI*

FATCA (continued)

- Increasing Focus on Intergovernmental Agreements ("IGAs")
  - Eight signed or initialed; many more in the works
  - Designed to resolve local law conflicts
  - Two Models
    - *Model 1*
      - May be reciprocal or non-reciprocal
      - FFIs comply with local law, provide information to local government
    - *Model 2*
      - Non-reciprocal
      - FFIs provide information to the U.S., probably still need to enter into agreements with the U.S.

FATCA (continued)

- FATCA compliance is complicated for Global Asset Managers
  – USWAs have different obligations than foreign entities (reciprocal reporting under IGAs?)
  – FFIs have different obligations than NFFEs
  – FFIs within an IGA country will have different obligations than FFIs in a non-IGA country
  – FFIs in IGA countries will have different obligations depending on whether it is a Model 1 or Model 2 IGA

FATCA (continued)

- Highlights from the Final Regulations
  - Clarified effective dates
    - *1/1/14 onboarding processes need to be up and running and withholding on FDAP ("fixed or determinable, annual or periodical") income begins*
    - *Other key effective dates are generally pushed from 2015 to 2017*
  - Adopted a more targeted risk based approach to reduce some of the operational burden
  - Expansion of deemed compliant FFI categories
  - Centralized compliance
  - W-8 guidance
  - Responsible officers
  - Registration Portal

FATCA (continued)

- Open Items
  - Release of new forms and detailed instructions
    - *Withholding Certificates (W-8s)*
    - *Form 8966 (FATCA Report)*
    - *Form 1042 changes*
  - Release of the model FFI agreements
  - Revenue Procedure relating to the online registration process
  - Technical corrections
  - Coordinating guidance between Chapter 3 and Chapter 4 withholding
  - More details on Foreign Passthru Payments
  - Conclusion of more IGAs

Foreign Bank and Financial Reporting (“FBAR”)

- Background
  - Due by June 30 of each year
  - Required for persons who have a financial interest in or signature authority over a “foreign financial account”
- Two levels of filings
  - Fund level
    - *Financial interest*
  - Employee level
    - *Signature authority*

FBAR (continued)

- Signature Authority Concerns For Fund Sponsors
  - Longstanding reporting exception available to employees and officers of domestic corporations
  - Funds don’t have employees
    - *Authorized Service Provider exception*
    - *Direct communication*
  - Lingering Concerns
    - *Signature authority over non-registered funds or non-US funds*
    - *Parent/Sub, Brother/Sister, Foreign/Domestic*
    - *Employees whose payroll company is not an SEC registrant*

FBAR (continued)

- Prior Guidance Received
  - Notice 2011-1 – Extended the filing deadline until June 30, 2012 for individuals with signature authority over but no financial interest in a foreign financial account within a parent-sub/domestic-foreign context
  - Notice 2011-2 – Extended the filing deadline until June 30, 2012 for officers and employees of investment advisers registered with the SEC with signature authority but no financial interest in foreign financial accounts of persons that are not registered investment companies
  - Notice 2012-1 - Extended the filing deadline for those persons covered in Notices 2011-1 and 2011-2 until June 30, 2013.

- Latest Guidance Received
  - Notice 2012-2 – Extended the filing deadline until June 30, 2014 for those persons covered in Notice 2012-1.

- Concerns linger on and a potential landslide of employee filings may yet come due…..

Federal Tax Legislation

- American Taxpayer Relief Act of 2012
  - Tax Rates on Long-Term Capital Gains and Qualified Dividend Income
  - Qualified Five-Year Gain Provision Repealed Permanently
  - Backup Withholding Rate Maintained at 28 Percent
  - Flow-Through Provisions Extended (in Part)

Federal Tax Legislation (continued)

- Financial Products Tax Reform Discussion Draft
  – Released on January 24, 2013
  – House of Representatives Committee on Ways and Means Chairman Dave Camp (R-MI) leading effort
  – Documents released include summary description, technical explanation and draft bill language
  – Input requested from all stakeholders
  – Eight specific areas addressed

Federal Tax Legislation (continued)

- Specific Financial Products Provisions Include:
  - Mark-to-Market Treatment of Derivatives
  - Mandatory Use of Average Basis
  - Others
    - *Current Inclusion of Market Discount*
    - *Wash Sales by Related Parties*
    - *Treatment of Hedges Identified for Financial Accounting Purposes*
    - *Debt Modifications*

Federal Tax Legislation (continued)

- Proposed Financial Transactions Tax, or FTT
  - 0.03% tax on trades in stocks, bonds and derivative contracts
  - Exemption for original issuance of debt, all short-term debt and securities lending
  - Estimated to raise $352 billion over 10 years
  - Proposed effective date of 1/1/2014

Federal Tax Legislation (continued)

- Carried Interest and Enterprise Value Proposal
  - As in prior years, the Obama Administration budget has includes a proposal to change the tax treatment of carried interests earned in connection with investment management services.
  - Senator Levin (D-Michigan), chairman of the Senate Finance Committee, has proposed, as part of a Cut Unjustified Tax Loopholes Act, a Carried Interest Fairness Act of 2012.
  - Similar approach, including on sales of carried interests (the so-called “enterprise value tax”), to prior proposals.

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Sixth Annual Advanced Topics in

Hedge Fund Practices Conference:

Manager and Investor Perspectives

Securities Law Developments Affecting Hedge Funds

Mark D. Fitterman

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May 2, 2013

JOBS Act Provisions Affecting Hedge Funds as Investors

- "Initial Public Offering (IPO) on-ramp provisions for "emerging growth companies" (Title I)
- An "emerging growth company" (EGC) is defined as:
  - an issuer (including a foreign private issuer) with total annual gross revenues of less than $1 billion (subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year; and
  - first sold its common stock in a registered offering on or after December 9, 2011.

Testing-the-Waters Communications

- EGCs, or any person that they authorize, may engage in oral or written communications with QIBs and institutional accredited investors in order to gauge their interest in a proposed offering.
  - No content restriction or filing requirement, although staff will ask for copies on supplemental basis to assist in its review of EGC registration statements.
  - Apparently there is resistance by institutional investors to engage with issuers and underwriters early in the process.

Confidential Review Process for IPO Registration Statements

- Title I provides that the SEC staff must review all EGC IPO registration statements confidentially.
  - An EGC may confidentially submit a draft registration statement for an IPO for nonpublic review, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 21 days prior to the issuer's commencement of a "road show."
  - Test-the-waters communications are not a "road show" for purposes of the Securities Acts 21-day requirement.

Confidential Review Process (continued)

- If no road show, the issuer's registration statement and confidential submissions should be filed publicly no later than 21 days before the anticipated date of effectiveness of the registration statement.
- All confidential draft registration statements and exhibits are now submitted on EDGAR and must be publicly refiled when registration statements are made public.
- Foreign private issuers (FPI) can file as FPIs if dual listed or as EGCs.
  - FPIs not subject to 21-day waiting period.

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Disclosure Accommodations for EGCs

- An EGC is required to present only two years of audited financial statements in its IPO registration statement. An EGC may also limit its MD&A to only cover those audited periods presented in the audited financial statements.
  - Not being used other than to start registration process.
- Following an IPO, an EGC will not be subject to the Say-on-Pay, Say-on-Frequency, or Say-on-Golden Parachute vote required by the Dodd-Frank Act, for as long as the issuer qualifies as an EGC.

Disclosure Accommodations for EGCs
(continued)

- Subject to smaller public company level of compensation disclosure
  - need provide only a Summary Compensation Table (with three rather than five named executive officers and limited to two fiscal years of information), an Outstanding Equity Awards Table, and a Director Compensation Table, along with some narrative disclosures to augment those tables.
  - are not required to provide a Compensation Discussion and Analysis, or disclosures about payments upon termination of employment or change in control.

Disclosure Accommodations for EGCs
(continued)

- An EGC will not be required to adopt any update to FASB's Accounting until those standards apply to private companies.

- An EGC will not be subject to the requirement for an auditor attestation of internal controls pursuant to Section 404(b) of the SOX.

Research Reports

- The JOBS Act permits a broker-dealer to distribute a research report about an EGC IPO even if the broker-dealer will participate or is participating in the offering.
  - We have not seen pre-deal research, although firms may be moving to a 25-day, rather than 40-day, blackout.
- Further, no SRO or the SEC may adopt or maintain any rule or regulation prohibiting a broker-dealer from distributing a research report or making a public appearance with respect to the securities of an EGC following an offering or in a period prior to (although notably not after) expiration of a lock-up.

Research Analyst Communications

- A research analyst is permitted to engage in communications with an EGC's management when other employees of the investment bank, including the investment bankers, are present.
- The JOBS Act also removes restrictions on who within an investment bank can arrange for communications between research analysts and prospective investors in connection with an EGC IPO, permitting investment bankers to be involved in those arrangements.
- FINRA modified NASD Rule 2711 in order to bring it in line with the JOBS Act.

Short Sales – Short Tender Rules

- The SEC's short tendering rule, Exchange Act Rule 14e-4, prohibits short tendering and hedge tendering in connection with partial tender offers.
- The rule reflects the SEC's determination that permitting hedge tendering would give market professionals an unfair advantage with respect to "proration risk."
- The rule requires a tendering person to have a net long position to the extent of its tender both at the time of the tender and at the end of the proration period.

Short Sales – Short Tender Rules (continued)

- A person's net long position is the excess of his "long position" over his "short position."
  - A person's "long position" includes shares he owns, as well as convertible securities or options that have been converted or exercised (even if shares not yet delivered).
  - A person's "short position" includes shares sold, shares on borrow, shares underlying short nonstandardized calls, and shares underlying in-the-money standardized calls written after the announcement of the tender offer.
  - A person's "short position" does not generally include swaps.

Short Sales – Short Tender Rules (continued)

- The short tender rule can therefore be violated if a person tendering shares writes an OTC option or writes an in-the-money standardized call after the date of the announcement of the tender offer. A properly structured short swap, however, should not affect the tendering person's net long position.

Short Sales – Short Tender Rules (continued)

- Net long position determined on a firmwide basis, not based on separate aggregation units.
- It is permissible to effect short sales of shares after tendering them so long as:
  - The tendering person has a net long position at the time of the tender; and
  - The short sale is covered prior to the end of the proration period.

Long/Short Strategy in Partial Exchange Offers

- When-issued trading in security to be received in exchange offer.
  - Exchange will often facilitate trading in newly issued shares prior to close of exchange offer.
- When-issued sales may be cancelled by agreement with the counterparty to the when-issued trade, or by entering an offsetting purchase.
- Settlement of when-issued trades will be timed to coincide with availability of shares from the offer.
  - E.g., if the exchange offer expires on a Tuesday, the first regular way-trade date in the common shares to be issued will also be Tuesday, and those trades and the when-issued trades will all settle on the Friday of that week.

Long/Short Strategy in Partial Exchange Offers (continued)

- Marking Trade as Long or Short
  - Persons tendering into exchange offers may be deemed long due to the security to be received in the offer based on the number of securities tendered and a conservative estimate of the maximum proration factor (assume an offer for preferred in exchange for common).
    - *E.g., if issuer tendering for half the outstanding class of preferred, you may assume 100% of amount outstanding tendered and only 50% of amount tendered accepted. A less conservative estimate of the maximum proration factor based on under 100% participation is permissible, if the assumptions are reasonable and documented.*
  - Withdrawal of tendered shares will require adjustment of net long or short position in when-issued market.
    - *If initially marked long because of the amount of preferred tendered, position in common may have to be reclassified as short.*

Long/Short Strategy in Partial Exchange Offers (continued)

- Application of locate rule to short sales in when-issued market
  - If deemed long the common, no need to provide locate when selling into when-issued market.
    - *If selling into regular way market for common, will be a short sale even if sufficient securities tendered, since will have to borrow to make delivery.*
  - If short the common because have not tendered sufficient preferred to be long the common (when combined with any long position in common), the sale into when-issued market is permissible but must be marked as a short sale.
  - No guidance on whether a short sale into the when-issued market requires compliance with the locate rule.
    - *Locate may not be available because the class does not exist prior to issuance, e.g., spin offs.*

Short Swaps – Short Tender Rules

- As previously mentioned, as a general matter a properly structured short swap should not affect a tendering person's net long position.
  - But it is worth considering potential recharacterization risk
    - *Should the swap be viewed as something other than a swap (e.g., a disguised cash trade) that could therefore reduce the tendering person's net long position?*

Short Swaps – Short Tender Rules (continued)

- Structuring possibilities to reduce potential recharacterization risks include:
  - Dealer control of whether and how it hedges
    - *Swap documents should be clear that the fund counterparty does not direct how the dealer hedges the swap, or even if it hedges at all*
  - Objective pricing
    - *Legging into the swap using a VWAP price instead of actual execution prices of the dealer's hedge*
    - *Unwinding the swap, to the extent possible, using a VWAP price instead of actual execution prices of the dealer's hedge.*
  - Duration of the swap
    - *Establishing some minimum duration for the swap before which it cannot be unwound.*

Limit Up/Limit Down

- Phase 1 rollout of the Limit Up/Limit Down (LULD) began on April 8, 2013.
  - Also made changes to marketwide circuit breakers
- The LULD plan, which was approved on a pilot basis, is intended to address extraordinary market volatility
  - Flash Crash of May 6, 2010.
- The LULD plan is designed to prevent transactions in individual Regulation NMS stocks from happening beyond certain specified price bands.
- LULD replaces the single-stock circuit breakers.

Limit Up/Limit Down – Price Bands

- Price bands will consist of a lower and an upper price band for each NMS stock as calculated by the two securities information processors (SIPs) – CTA and Nasdaq UTP.
- When the national best bid is below the lower price band, the SIP will identify the national best bid as unexecutable.
- When the national best offer is above the upper price band, the SIP also will identify the national best bid as unexecutable.

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Limit Up/Limit Down – Price Bands (continued)

- For Tier 1 NMS Stock – S&P 500 Index, Russell 1000 Index, certain exchange-traded products – the percentage parameters are
  - 5% if the previous closing price is greater than $3.00
  - 20% if the previous closing price is between $0.75 and $3.00
  - The lesser of $0.05 or 75% if the previous closing price is less than %0.75

Limit Up/Limit Down – Price Bands (continued)

- For Tier 2 – all NMS stock not in Tier 1 – the percentage parameters are
  - 5% if the previous closing price is greater than $3.00
  - 20% if the previous closing price is between $0.75 and $3.00
  - The lesser of $0.05 or 75% if the previous closing price is less than %0.75

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Limit Up/Limit Down – Price Bands (continued)

- The reference price will be the arithmetic means of eligible reported transactions over the past 5 minutes.
- If no eligible trades have occurred in the previous 5 minutes, the previous reference price remains the same.
- Reference price is only updated if the new reference price is at least 1% away in either direction.
- If upper/lower band limits are reached, trading pauses can occur for 5 minutes.

Limit Up/Limit Down – Phases

- Implementation Dates
  - April 8, 2013 – LULD Phase 1 Rollout Begins
  - May 31, 2013 – LULD Phase 1 Rollout Complete
  - August 1, 2013 – LULD Phase 2 Rollout Begins
  - September 30, 2013 – LULD Phase 2 Rollout Complete
- Differences between Phase 1 and Phase 2
  - Phase 1 applies to Tier 1 and is effective between 9:45 a.m. and 3:30 p.m.
  - Phase 2 applies to Tier 2 and is effective between 9:30 a.m. and 4:00 p.m.

Changes to Market Wide Circuit Breakers

- Previous Marketwide Circuit Breakers
  - 10%, 20%, and 30%
- Revised Marketwide Circuit Breakers
  - 7%, 13%, and 20%
- Market decline measures from S&P 500 Index, no longer from the DJIA

Circuit Breakers and Time Durations

- Level 1 Halt – 7% decline in S&P 500
  - Before 3:25 p.m. – 15 minutes
  - At or after 3:25 p.m. – trading shall continue unless a Level 3 halt
- Level 2 Halt – 13% decline in S&P 500
  - Before 3:25 p.m. – 15 minutes
  - At or after 3:25 p.m. – trading shall continue unless a Level 3 halt
- Level 3 Halt
  - At any time – trading halts for rest of day

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- Level 2 Halt – 13% decline in S&P 500
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  - At or after 3:25 p.m. – trading shall continue unless a Level 3 halt
- Level 3 Halt
  - At any time – trading halts for rest of day

A Few Observations in the Private Fund Space

by

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American Bar Association, Trading and Markets Subcommittee
Washington, D.C.
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Thank you very much, Dana [Fleischman, Chair of the Trading and Markets Subcommittee] for your kind words and for inviting me to speak with you today.

I have had the great pleasure over the last year or so to work with Dana and other members of the Trading and Markets Subcommittee and other ABA groups on a number of initiatives surrounding one broad and oftentimes tricky question: when is a person required to register with the SEC as a broker-dealer? Not exactly a prime subject for a TED Talk, but this group knows how vitally important it is to settle some of the questions that have been open for a decade or more about who needs to register with the SEC as a broker-dealer.

I and my staff have already begun talking with you about such perennial hits as placement agents, so-called "finders," and business or M&A brokers. Most recently, we have had lengthy discussions with various members of this subcommittee about Rule 15a-6, the rule exempting from registration certain non-U.S. resident persons engaged in business as a broker or dealer entirely outside the U.S. These discussions led the staff to publish responses to frequently asked questions about the rule to address some of the issues that you have told us have been a source of confusion.[1] We view the FAQs as an initial set of staff guidance about issues that commonly arise under Rule 15a-6. They do not break new ground, but I believe they are important to ensuring that regulators and market participants are operating under a common understanding of how the rule works. We are very much open to exploring opportunities for additional guidance through subsequent FAQs.

We also have had broader discussions with many of you about Rule 15a-6, including whether there are opportunities to more fundamentally update the rule, which was adopted in 1989 when the globalization of the securities markets was just emerging. I approach this topic with an open mind, and also a belief that Rule 15a-6 should be complementary to — though not necessarily identical to — the cross-border approach that the SEC may take with respect to the security-based swaps market.

While Rule 15a-6 is a perennial topic, so too are others that we have been discussing with various members and committees of the ABA, as well as other interested groups. I have in mind the broker-dealer registration requirements as they apply to the group I mentioned earlier — placement agents, finders, and business or M&A brokers. The staff has been considering a wide spectrum of options for certain of these market participants, ranging from potential recommendations for exemptions to working collaboratively with FINRA on a more customized approach for regulation of market participants who perform only limited broker functions. The staff's consideration of this latter approach, which has the potential benefit of removing some barriers to entry, has been greatly facilitated by the work being done for the regulation of funding portals. Introduced by the JOBS Act, funding portals are intended to perform limited functions for crowdfunding offerings. Because their functions are limited (for example, they do not come into possession of customer funds or securities or provide investment advice), funding portals receive lighter regulatory treatment, including being subject to a customized set of rules under FINRA's rulebook (as compared to fully registered broker-dealers) and receiving an exemption from broker registration with the SEC. Needless to say, the staff is continuing to think through the appropriate registration and regulation structure for funding portals, and learning from that experience to see if there are opportunities to extend the approach to other types of brokers whose activities are limited.

Today, I would like to add a new topic of discussion that refers back to our broad theme of broker-dealer registration. The issue arises in the private fund adviser world. *Before I get started on that topic, though, please let me remind you that my remarks represent my own views, and not those of the Commission, any individual Commissioner, or any other members of the staff.*

As you are well aware, private funds have become an increasingly large part of the financial marketplace in the last couple of decades. Their significance was recognized in the Dodd-Frank Act, and related SEC rules, which impose new registration and reporting requirements on private fund advisers. Following suit, the staff is putting an increased examination focus on private fund advisers, both due to the new regulatory requirements and our own observations in the private fund space.

Many private fund advisers are quite rightly coming to terms with the requirements under the Investment Advisers Act of 1940 that are newly applicable to them and are probably focused on recent enforcement actions under that Act and concerns expressed by the SEC's senior enforcement and examination teams.[2] While it is absolutely right and appropriate that private fund advisers devote their resources to complying with the requirements under the Advisers Act, I would like to be sure that the private fund adviser community is not overlooking significant area of concern under the Securities Exchange Act of 1934 — activity that could cause a private fund adviser to be required to register as a broker-dealer.

The reason I focus on the broker-dealer issue in this context is because of some practices that the staff has observed in connection with newly registered private fund advisers. This is an issue that warrants some attention before examiners arrive. To date, the issue has come in two flavors. I will describe these in more detail shortly, but the first flavor (let's call it plain vanilla) involves a fund adviser that pays its personnel transaction-based compensation for selling interests in a fund or that has personnel whose only or primary functions are to sell interest in the fund. In the second flavor (a bit more unusual, say dark chocolate with a subtle infusion of habanero), the private fund adviser, its personnel, or its affiliates receive transaction-based compensation for purported investment banking or other broker activities relating to one or more of the fund's portfolio companies. The staff understands that this second practice is common at advisers of certain types of funds, such as private equity funds that execute a leveraged buyout strategy. I should note that these issues are not unique to advisers to private equity funds or even advisers to private funds. Advisers to other types of funds, including business development companies, also will want to think through their practices.

Sales of interests in a private fund

In a speech several years ago, the Director of the Division of Investment Management at the time expressed concern that some participants in the private fund industry may be inappropriately claiming to rely on exemptions or interpretive guidance to avoid broker-dealer registration.[3] As this group knows quite well, absent an available exemption or other relief, a person engaged in the business of effecting transactions in securities for the account of others must generally register under Section 15(a) of the Exchange Act as a broker.[4]

The test for broker-dealer registration is broad and depends on various activities a person performs in one or more securities transactions.[5] Some examples of activities, or factors, that might require private fund adviser personnel to register as a broker-dealer include:

- Marketing securities (shares or interests in a private fund) to investors,
- Soliciting or negotiating securities transactions, or
- Handling customer funds and securities.

The importance of each of these activities is heightened where there also is compensation that depends on the outcome or size of the securities transaction — in other words, transaction-based compensation, also referred to as a "salesman's stake" in a securities transaction. The SEC and SEC staff have long viewed receipt of transaction-based compensation is a hallmark of being a broker.[6] This makes sense to me as the broker regulatory structure is built, at least in large part, around managing the conflict of interest arising from a broker acting as a securities salesman, as compared to an investment adviser which traditionally acts as a fiduciary and which should not have that same type of conflict of interest.

With this backdrop, a private fund adviser (or counsel to a private fund adviser) should think through how the adviser goes about obtaining new investors and retaining existing investors. That is not to say that all investment-raising by a private fund adviser results in the adviser being a broker-dealer. We do not look at the world through that type of prism. Based on my own experience, however, I believe that private fund advisers may not be fully aware of all of the activities that could be viewed as soliciting securities transactions, or the implications of compensation methods that are transaction-based.

An example of this area of focus is the recent *Ranieri Partners* enforcement action.[7] Just last month, the SEC settled charges in connection with alleged violations of Section 15(a) of the Exchange Act against Ranieri Partners, which is a New York-based private equity firm, and also with a former senior executive of Ranieri Partners and an independent consultant hired by Ranieri Partners.[8] The Commission's order found that Ranieri Partners paid transaction-based fees to the consultant, who was not registered as a broker, for the purpose of actively soliciting investors for private fund investments. The Commission's cases demonstrate that there are serious consequences for acting as an unregistered broker, even where there are no allegations of fraud. It is important, I believe, for market participants to keep in mind that the willingness for one to act as an unregistered broker can be a strong indicator of other potential misconduct, especially where the unregistered broker-dealer comes into possession of funds and securities.

In order to help private fund advisers think through this a little more, and to give some specific examples, I thought I would run through some questions private fund advisers might want to ask themselves with respect to activities or services that they may perform. Determining whether a person is a broker-dealer can be fairly fact intensive and these questions are the types we ask ourselves when making that kind of determination. For example, the adviser might want to consider the following:

- How does the adviser solicit and retain investors? I recommend some thinking go into the duties and responsibilities of personnel performing such solicitation or marketing efforts. This is an important consideration because a dedicated sales force of employees working within a "marketing" department may strongly indicates that they are in the business of effecting transactions in the private fund, regardless of how the personnel are compensated.

- Do employees who solicit investors have other responsibilities? If so, consider what those responsibilities are (*i.e.*, are the primary functions of these employees to solicit investors).

- How are personnel who solicit investors for a private fund compensated? Do those individuals receive bonuses or other types of compensation that is linked to successful investments? As previously noted, a critical element to determining whether one is required to register as a broker-dealer is the existence of transaction-based compensation.[9]

- Do you charge a transaction fee in connection with a securities transaction? In addition to considering compensation of employees, advisers also need to consider the fees they charge and in what way, if any, they are linked to a security transaction (more on this topic below).

Some ask us about the so-called "issuer exemption" in the context of private fund advisers. That exemption, found in Exchange Act Rule 3a4-1, provides a nonexclusive safe harbor under which associated persons of certain issuers can participate in the sale of an issuer's securities in certain limited circumstances without being considered a broker.[10] As you all know, Rule 3a4-1 generally is not used by private fund advisers. Furthermore, and just by way of example, a person must satisfy one of three conditions to claim the issuer exemption from broker-dealer registration:

- the person limits the offering and selling of the issuer's securities only to broker-dealers and other specified types of financial institutions;

- the person performs substantial duties for the issuer other than in connection with transactions in securities, was not a broker-dealer or an associated person of a broker-dealer within the preceding 12 months, and does not participate in selling an offering of securities for any issuer more than once every 12 months; or

- the person limits activities to delivering written communication by means that do not involve oral solicitation by the associated person of a potential purchaser.

It could be difficult for private fund advisers to fall within these conditions.

I am keenly aware that many advisers, particularly smaller advisers, may not be able to afford or be able to either hire a broker-dealer or register as broker-dealers themselves. By raising the issues that I have just described, I am not saying that they need to do that in all circumstances. There is a wide array of options available to private fund advisers to raise funds without triggering broker registration concerns. My purpose is to assist advisers in reviewing their activities to be sure they are aligned with existing legal requirements. I would also be interested in hearing from this group and others whether a broker-dealer registration exemption written specifically for private fund advisers is needed or would be helpful. I have in mind a potential exemption like the issuer exemption, but one written specifically for private fund advisers. Certainly, the receipt of transaction-based compensation is a problematic practice in this context, but what other parameters might apply if there was an express exemption written specifically for private fund advisers?

Broker-dealer issues arising from private equity fund practices

On a related note, the staff has observed that that advisers to some funds — for example, advisers to private equity funds executing a leverage buyout strategy — may also collect many other fees in addition to advisory fees, some of which call into question whether those advisers are engaging in activities that require broker-dealer registration. Examples include fees the manager directs a portfolio company of the fund to pay directly or indirectly to the adviser or one of its affiliates in connection with the acquisition or disposition (including an initial public offering) of a portfolio company or a recapitalization of the portfolio company. The fees are described as compensating the private fund adviser or its affiliates or personnel for "investment banking activity," including negotiating transactions, identifying and soliciting purchasers or sellers of the securities of the company, or structuring transactions.

Looking back to the earlier analysis of what makes one a broker, this practice appears to involve transaction-based compensation that is linked to the manager effecting a securities transaction. The combination of success fees which cause the adviser to take on a salesman's stake and the activities involved in effecting securities transactions appear, at least on their face, to cause such an adviser to fall within the meaning of the term "broker."

I understand that the practice of charging these transaction fees might be common among some private fund adviser and I am very much open to talking over our broker analysis with interested parties. For example, we have been told that one rationale advisers might put forth for why these activities and payment schemes do not raise broker-dealer status issues is where the payments offset or otherwise reduce the amount of the advisory fee payable by the fund. To the extent the advisory fee is wholly reduced or offset by the amount of the transaction fee, one might view the fee as another way to pay the advisory fee, which, in my view, in itself would not appear to raise broker-dealer registration concerns.

Another rationale that has been brought to the staff's attention focuses on the recipient of the fee. Here, the general partner of the fund (where the general partner is also the adviser to the fund or an affiliate of the adviser) directly or indirectly receives the transaction fee. We are told that the general partner should be viewed as the same person as the fund, so there are no transactions for the *account of others*. This explanation does not seem plausible to me — if the general partner and the fund are the same, why is it that the fee is paid to anyone other than the fund. That the fee is paid to someone other than the fund — here the general partner — makes crystal clear to me that, at least for potential broker-dealer status questions, the fund and the general partner are distinct entities with distinct interests.

Others have questioned why the staff would want to require a private equity fund managers to register as a broker-dealer. While certainly an interesting policy question, I approach this issue from another perspective. Unless prepared to register as a broker, a person should not engage in activities that trigger registration. To my knowledge, there is no exemption or other relief available for the activity that I described above. Taking the activity out of the private equity space and applying it in other contexts would leave little question about the need for broker-dealer registration.[11] Investors in the fund, furthermore, may or may not be in a position to monitor the adviser's activity and fees. It does not appear difficult to me for a private equity fund adviser to change its practices so it is not engaging in activities that raise broker-dealer status questions. Again, the staff is interested in talking these issues over, but I encourage advisers to private funds to think through these practices.

Closing remarks

I raise all these issues to bring them to the attention of private fund advisers and their counsel, so they can grapple with them hopefully in advance of a visit from the SEC's examiners. Also, while some out there might think that acting as an unregistered broker-dealer should be viewed as only a technical violation, I want to take a moment and caution that engaging in these activities without registering can have serious consequences. In addition to being subject to sanctions by the SEC, another possible consequence of acting as an unregistered broker-dealer is the potential right to rescission. In other words, securities transactions intermediated by an inappropriately unregistered broker-dealer could potentially be rendered void.[12] Given the significant consequences of acting as an unregistered broker-dealer and the increased attention being given to this issue by the SEC staff, private fund advisers should consider reviewing their practices to determine whether any activities that may be approaching or crossing the line would require broker-dealer registration.

In closing, I want to thank once again the ABA's Trading and Markets Subcommittee and others at the ABA for their willingness to engage in a fruitful dialogue on a number of issues surrounding broker-dealer registration requirements. With new oversight of private fund advisers comes the opportunity to take proactive steps to avoid problems. These steps can include reviewing the standards for broker-dealer registration and previous staff guidance and to review business activities with these standards in mind. They also can include a dialogue with us about the potential need for relief with appropriate conditions or other parameters. I appreciate the opportunity to share my thoughts on these important issues with you. As I'm sure you are aware, the staff at the SEC is fully committed to our mission of protecting the nation's investors and we view maintaining an ongoing dialogue with market participants as critical to carrying out this mission.

Thank you, and I would be happy to answer any questions you might have.

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[1] The Rule 15a-6 staff FAQs are available at: sec.gov/divisions/marketreg/faq-15a-6-foreign-bd.htm.

[2] *See*, *e.g.*, Speech, *Private Equity Enforcement Concerns*, Bruce Karpati, Chief, SEC Enforcement Division's Asset Management Unit (January 23, 2013), available at: sec.gov/news/speech/2013/spch012313bk.htm#P14_514; Speech, *Enforcement Priorities in the Alternative Space*, Bruce Karpati, (December 18, 2012), available at: sec.gov/news/speech/2012/spch121812bk.htm; Speech, *Address at the Private Equity International Private Fund Compliance Forum*, Carlo V. di Florio, Director, SEC's Office of Compliance Inspections and Examinations, available at: http://www.sec.gov/news/speech/2012/spch050212cvd.htm.

[3] Speech, *Keynote Address at the ALI-ABA Compliance Conference*, Andrew J. Donohue, Director, SEC's Division of Investment Management (June 3, 2010), available at: http://www.sec.gov/news/speech/2010/spch060310ajd.htm.

[4] Section 3(a)(4) of the Exchange Act defines a "broker" generally as "any person engaged in the business of effecting transactions in securities for the account of others." A person may be found to be acting as a broker if that person participates in securities transactions "at key points in the chain of distribution." Massachusetts Financial Services, Inc. v. Securities Investor Protection Corp., 411 F. Supp. 411, 415 (D. Mass.), *aff'd,* 545 F.2d 754 (1st Cir. 1976), *cert. denied*, 431 U.S. 904 (1977).

[5] Section 3(a)(5) of the Exchange Act defines "dealer" as "any person engaged in the business of buying and selling securities…for such person's own account through a broker or otherwise." Generally speaking, private fund advisers' activities typically do not cause the adviser to fall within the meaning of the term "dealer."

[6] Although the receipt of compensation in connection with a purchase or sale of securities generally requires, as a practical matter, registration or association with a registered broker-dealer, it is important to understand that the receipt of transaction-based compensation in connection with securities transactions is not a necessary element to require broker-dealer registration. In other words, one can be acting as a broker-dealer without having received transaction-based compensation.

[7] *See* In the Matter of Ranieri Partners LLC and Donald W. Phillips, SEC Release No. 34-69091, Administrative Proceeding File No. 3-15234 (March 8, 2013); *see also* In the Matter of William M. Stephens, SEC Release No. 34-69090, Administrative Proceeding File No. 3-15233.

[8] The Commission ordered Ranieri Partners to pay a civil monetary penalty of $375,000 and the senior executive of the fund to pay a penalty of $75,000. The Commission also barred the independent consultant from the securities industry.

[9] Consider *Ranieri Partners* in this context — the unregistered consultant was compensated a percentage of all capital commitments made to the funds by investors introduced by the consultant.

[10] A provision in Title II of the JOBS Act provides an exemption from broker-dealer registration for so-called "Regulation D portals." Under new Section 4(b) of the Securities Act, a person can offer and sell securities in compliance with Rule 506 of Regulation D under the Securities Act without becoming subject to registration as a broker or dealer where certain conditions are met. Among other things, the person and each person associated with that person may receive no compensation in connection with the purchase or sale of those securities. The prohibition on compensation makes it unlikely that a person outside the venture capital area would be able to rely on the exemption from broker-dealer registration. For more information, including information on forms of

compensation, see FAQs published by the Division of Trading and Markets, available at: sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm.

[11] The practices described may not be unique to private equity fund managers — they may also be prevalent for other funds, including business development companies, in which case the analysis should be the same.

[12] Section 29(b) of the Exchange Act. *See* Reg'l Props., Inc. v. Fin. And Real Estate Consulting Co., 678 F.2d 552 (5th Cir. 1982); *see also,* Eastside Church of Christ v. Nat'l Plan, Inc., 391 F.2d 357 (5th Cir.), cert. denied, 393 U.S. 913 (1968).

http://www.sec.gov/news/speech/2013/spch040513dwg.htm

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69091 / March 8, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3563 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15234

In the Matter of

Ranieri Partners LLC and Donald W. Phillips,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Donald W. Phillips ("Phillips" or "Respondent Phillips"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and that cease-and-desist proceedings be, and hereby are, instituted against Ranieri Partners LLC ("Ranieri Partners" or "Respondent Ranieri Partners") pursuant to Section 21C of the Exchange Act.

II.

In anticipation of the institution of these proceedings, the Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and the Respondents' Offers, the Commission finds[1] that:

Summary

From February 2008 through March 2011, William M. Stephens ("Stephens") operated as an unregistered broker in violation of Section 15(a) of the Exchange Act. While working as an independent consultant for Ranieri Partners, Stephens actively solicited investors on behalf of private funds managed by Ranieri Partners' affiliates and, in return, received transaction-based compensation totaling approximately $2.4 million. Stephens' solicitation efforts included: (1) sending private placement memoranda, subscription documents, and due diligence materials to potential investors; (2) urging at least one investor to consider adjusting its portfolio allocations to accommodate an investment with Ranieri Partners; (3) providing potential investors with his analysis of Ranieri Partners' funds' strategy and performance track record; and (4) providing potential investors with confidential information relating to the identity of other investors and their capital commitments. By these actions, Stephens engaged in the business of effecting transactions in securities without first being registered as a broker or dealer or associated with a registered broker or dealer. Ranieri Partners and Donald W. Phillips ("Phillips"), its then Senior Managing Partner, provided Stephens with key documents and information related to Ranieri Partners' private equity funds and did not take adequate steps to prevent Stephens from having substantive contacts with potential investors.

Respondents

1. Ranieri Partners is a holding company located in New York, New York. It controls Selene Investment Partners LLC and Selene Investment Partners II LLC, which managed the investments of Selene Residential Mortgage Opportunity Fund L.P. ("Selene I") and Selene Residential Mortgage Opportunity Fund II L.P. ("Selene II") (collectively the "Selene Funds"). On March 26, 2012, Ranieri Residential Investment Advisors, LLC ("RRIA"), another entity controlled by Ranieri Partners, registered with the Commission as an investment adviser and now is the investment adviser to the Selene Funds.

2. Donald W. Phillips, age 63, resides in Barrington, Illinois. Phillips was a Senior Managing Partner of Ranieri Partners before resigning in December 2012. At the time of the conduct at issue, Phillips also was a managing member of a Chicago-based registered investment adviser.

Other Relevant Individuals

3. William M. Stephens, age 60, resides in Hinsdale, Illinois. From 1986 to 1998, Stephens was an asset manager for various public and private pension funds. From 1998 to 2000, Stephens was the Chief Investment Strategist at a San Francisco-based registered investment

[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

adviser. In June 2000, the Commission instituted public administrative and cease-and-desist proceedings against Stephens and, in November 2002, the Commission entered an order, based on an offer of settlement by Stephens, finding that Stephens violated certain provisions of the federal securities laws in connection with the investment of pension fund assets. Stephens agreed to the entry of an order requiring him to cease and desist from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Sections 206(1) and 206(2) of the Advisers Act. The Commission also barred Stephens from association with any investment adviser, with the right to reapply after two years, and imposed a $25,000 civil penalty. Stephens never reapplied for permission to become associated with an investment adviser. Since 2002, Stephens has not been registered with the Commission in any capacity, including as a broker or dealer.

Background

4. In January 2008, Ranieri Partners established the Selene I private investment fund. Selene I's investment strategy was to use investor capital to purchase underperforming or nonperforming residential mortgages, or loan portfolios, at a discount, rehabilitate the mortgages, and then resell them to traditional mortgage companies at a premium. The Private Placement Memorandum ("PPM") for Selene I also permitted the fund to purchase mortgage-backed securities. In 2010, Ranieri Partners formed Selene II. Selene II's investment strategy focused on generating returns from the rehabilitation of distressed residential mortgages.

5. Phillips, a Senior Managing Partner of Ranieri Partners, was in charge of raising capital for the Selene Funds. Phillips was a long-time friend of Stephens. In February 2008, Phillips caused an affiliate of Ranieri Partners to retain Stephens as an independent consultant to find potential investors for Selene I. At the time, Phillips was generally aware of Stephens' prior disciplinary history with the Commission. In 2010, Phillips again caused an affiliate of Ranieri Partners to retain Stephens to find potential investors, this time for Selene II.[2]

6. Ranieri Partners agreed to pay Stephens a fee equal to 1% of all capital commitments made to the Selene Funds by investors introduced by Stephens.

7. Phillips was responsible for coordinating the activities of Stephens and others engaged by Ranieri Partners to find potential investors for the Selene Funds. According to Phillips, he informed Stephens that Stephens' activities on behalf of Ranieri Partners were limited to contacting potential investors to arrange meetings for the principals of Ranieri Partners and that he specifically informed Stephens that he was not permitted to provide PPMs directly to potential investors. Ranieri Partners controlled the distribution of PPMs for the Selene Funds. According to Phillips, he also informed Stephens that Stephens was not permitted to contact investors directly to discuss his views of the merits and strategies of the Selene Funds.

8. Phillips and other Ranieri Partners personnel provided Stephens with materials relating to the Selene Funds. On February 29, 2008, Phillips sent Stephens several copies of a Selene I Executive Summary, which summarized the fund's investment strategy and provided

[2] In both instances, the terms of Stephens' engagement were reflected in consulting services agreements prepared by outside counsel to Ranieri Partners.

Ranieri Partners' view of the distressed mortgage market and the firm's competitive advantages in the distressed real estate space. On March 1, 2008, Ranieri Partners personnel provided Stephens with a copy of the Selene I PPM and, subsequently, provided Stephens with supplemental PPMs, subscription documents, and presentation materials. Ranieri Partners personnel also provided Stephens with marketing materials for Selene II, including an Executive Summary and PPM, as well as Ranieri Partners' overall business plan.

Stephens Solicited Investors for Selene I

9. Beginning in February 2008, Stephens contacted certain of his acquaintances and former colleagues in the pension fund investment community concerning a possible investment in Selene I.

10. In February 2008, Stephens contacted a former colleague who was the Director of Retirement Investments (hereinafter referred to as "Executive X") for a private corporation (hereinafter referred to as "Company X"). On February 26, 2008, Stephens contacted Executive X to set up a meeting among himself, Executive X, and Phillips. On February 28th, Stephens and Phillips met with Executive X. During the meeting, Phillips described a possible investment in Selene I. After the meeting, Stephens continued to communicate with Executive X directly via email. On March 4th, Stephens provided Executive X with details about Selene I's investment strategy. On April 29th, Stephens emailed Executive X to inform her that he provided due diligence materials regarding Selene I to a consultant that advises Company X on money manager selection and retention. In the same email, Stephens described the Selene I investment as "a rare opportunity to earn above market returns," and encouraged Executive X to consider adjusting Company X's asset allocation plan to take advantage of the Selene I opportunity. Also, Stephens traveled to various cities on four separate occasions in 2008 to meet with Company X's consultant, who was a friend and former consultant to pension funds managed by Stephens. Stephens continued to call upon Company X for an investment in Selene I until at least April 2009, when he again flew to the company's headquarters to meet with Executive X. Despite Stephens' efforts, Company X did not invest in Selene I.

11. In March 2008, Stephens contacted the Chief Investment Officer ("CIO") of an endowment fund of a Midwestern university ("Endowment X") regarding a possible investment in Selene I. Stephens had a close connection to the CIO, who worked for Stephens in the late 1990s when Stephens was the CIO of a large corporate pension fund. Stephens set up a meeting with the CIO to discuss Selene I. At the meeting, Stephens and Phillips met with the CIO and other members of his staff. During the meeting, Phillips made a presentation concerning a possible investment in Selene I. Shortly after the meeting, Stephens sent a copy of the Selene I PPM and other subscription materials to an Endowment X staff member. On April 21st, Stephens sent an email to the same staff member that contained a list of current and prospective investors for Selene I. In the email, Stephens listed the expected dates and amounts of the investors' respective capital commitments and then explained that there was a cap on the amount of investments that would be allowed in Selene I. On April 23rd, Stephens sent another email to the staff attaching additional due diligence materials on Selene I. On June 30, 2008, Endowment X committed $65 million in capital to Selene I. Pursuant to his agreement with Ranieri Partners, Stephens was to be paid $650,000 on the investment.

12. In April 2008, Stephens used a subagent to reach out to the retirement system for a Southern state ("State Retirement System X") concerning a possible investment in Selene I. Stephens' subagent arranged a meeting for Phillips to meet with the CIO of State Retirement System X and his staff. Stephens' subagent accompanied Phillips to the meeting, which took place in April 2008. On June 30, 2008, State Retirement System X invested $200 million in Selene I. As a result, Ranieri Partners owed Stephens a fee equal to 1% ($2 million) of the total capital commitment. Pursuant to a side agreement between Stephens and his subagent, 80% of Stephens' fee was to be paid to the subagent.

Stephens Solicited Investors for Selene II

13. Between August 2010 and March 2011, Stephens contacted Executive X about a possible investment by Company X in Selene II. Stephens traveled to Company X's headquarters to discuss Selene II with Executive X and then traveled to meet with Company X's consultant. Stephens also drafted correspondence, for Phillips' signature, that addressed key questions about the potential investment that were raised by Executive X. Stephens continued to contact Executive X until at least March 2, 2011. Once again, despite Stephens' efforts, Company X did not invest in Selene II.

14. In August 2010, Stephens contacted the CIO of Endowment X about a possible investment in Selene II. In an email dated August 4th, Stephens told the CIO and another staff member of Endowment X that the "returns to [Selene I] have been strong and the outlook for [Selene II] looks real positive with Ranieri Partners taking on the role of market leader in this space." In the same email, Stephens told the CIO that Endowment X would pay a lower management fee if it made a commitment before the first closing date for the fund. Stephens also traveled on two occasions to discuss Selene II with the CIO. On October 15th, Endowment X invested $30 million in Selene II. Pursuant to Stephens' agreement with Ranieri Partners, he was to receive 1% of the funds invested by Endowment X, or approximately $300,000.

15. In 2009, Stephens contacted State Retirement System X regarding an investment in Selene II. Stephens and his subagent traveled to meet with the CIO of State Retirement System X on two occasions in 2009. In addition, after State Retirement System X invested in Selene I, its investment office staff stayed in direct contact with Ranieri Partners. After these meetings and contacts, State Retirement System X invested $150 million in Selene II and an additional $124 million in a special purpose investment vehicle established by Ranieri Partners specifically for State Retirement System X. Pursuant to a new agreement negotiated between Stephens and Phillips, Ranieri Partners was to pay Stephens a fee equal to 0.3% of State Retirement System X's capital commitments, or approximately $822,000.

16. In total, investors introduced to Ranieri Partners by Stephens and/or his subagent committed $569 million to funds managed by Ranieri Partners, earning Stephens $3.772 million in fees. Ranieri Partners paid Stephens $2.4 million of the fees he earned. Ranieri Partners also reimbursed Stephens for travel and entertainment expenses he incurred in connection with raising capital for the Selene Funds. The expenses claimed by Stephens include trips to meet potential investors that Stephens took both with and without Phillips or any other Ranieri Partners personnel.

Stephens' expense reports show that he met with representatives of Company X, Endowment X, and State Retirement System X several times after initially introducing them to Ranieri Partners.

17. Stephens was not registered as a broker or dealer or associated with a registered broker or dealer at any time while he was soliciting investors on behalf of Ranieri Partners.

18. Ranieri Partners failed to adequately oversee Stephens' activities. Although Stephens was not permitted to send documents like PPMs and subscription agreements to potential investors, he was able to obtain such documents from Ranieri Partners, as Ranieri Partners failed to limit Stephens' access to key documents. Stephens, in turn, sent such documents to potential investors. Ranieri Partners also received Stephens' requests for expense reimbursements, which reflected Stephens' extensive contact with potential investors. Yet Ranieri Partners did nothing to monitor or limit Stephens' contact with investors.

19. Since the conduct in question, Ranieri Partners has modified its policies and procedures to provide that it would not retain a third party, including a finder or marketer, that was not a broker or dealer or registered representative of a broker or dealer to market or place any security or investment in any security of any affiliate of Ranieri Partners. Those revised policies and enhanced procedures were implemented in 2011 and were fully in place during 2012. The Commission considered the remedial efforts undertaken by Ranieri Partners in determining to accept Ranieri Partners' Offer.

20. Phillips assisted Stephens' in his solicitation efforts by providing Stephens with key fund documents and information. Phillips also failed to limit Stephens' activities despite knowing that Stephens was supposed to play a limited role in introducing potential investors. Further, Phillips eventually became aware that Stephens was having substantive communications with potential investors, yet he still failed to do anything to curb Stephens' activities. Phillips did little to monitor Stephens' activities other than hold a weekly meeting at which Stephens and others discussed their progress in raising capital for the Selene Funds.

Violations

21. As a result of the conduct described above, Ranieri Partners caused Stephens' violations of 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.

22. As a result of the conduct described above, Phillips willfully aided and abetted and caused Stephens' violations of Section 15(a) of the Exchange Act.

Undertakings

23. Phillips undertakes to provide to the Commission, within 15 days after the end of the nine-month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV, below.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that**:**

A. Ranieri Partners

1. Respondent Ranieri Partners shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

2. Respondent Ranieri Partners shall, within 30 days of the entry of this Order, pay a civil money penalty of $375,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

    (1) Respondent Ranieri Partners may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

    (2) Respondent Ranieri Partners may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand delivered or mailed to:

        Enterprise Services Center
        Accounts Receivable Branch
        HQ Bldg., Room 181, AMZ-341
        6500 South MacArthur Boulevard
        Oklahoma City, OK 73169

    Payments by check or money order must be accompanied by a cover letter identifying Ranieri Partners as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Timothy L. Warren, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604.

B. Phillips

1. Respondent Phillips shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

2. Respondent Phillips be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer,

municipal adviser, transfer agent, or nationally recognized statistical rating organization for a period of nine (9) months, effective on the second Monday following the entry of this Order.

3. Respondent Phillips shall, within 30 days of the entry of this Order, pay a civil money penalty of $75,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

   (1) Respondent Phillips may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

   (2) Respondent Phillips may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand delivered or mailed to:

   Enterprise Services Center
   Accounts Receivable Branch
   HQ Bldg., Room 181, AMZ-341
   6500 South MacArthur Boulevard
   Oklahoma City, OK 73169

   Payments by check or money order must be accompanied by a cover letter identifying Donald W. Phillips as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Timothy L. Warren, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604.

4. Respondent Phillips shall comply with the undertakings enumerated in Section III, paragraph 23, above.

By the Commission.

Elizabeth M. Murphy
Secretary

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Sixth Annual Advanced Topics in Hedge Fund Practices Conference: Manager and Investor Perspectives

Hedge Funds and the FCPA

Martha B. Stolley

May 2, 2013

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Topics for Discussion

- Why Hedge Funds Must Heed the FCPA
- The FCPA: An Overview
- FCPA Risks for Hedge Funds
- Managing FCPA Risks
  - Compliance Programs
  - Due Diligence
- Q&A

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Why Hedge Funds Must Heed the FCPA

New Era of Global Anti-Corruption Enforcement

- While the hedge fund world has avoided significant scrutiny under the FCPA to date, the industry's profile and operating procedures present risks funds must recognize and address.
- Successful investors will be those who recognize the importance of adequate pre-acquisition diligence and effective implementation of anti-corruption compliance policies that require the same level of commitment from target investments as from the parent hedge fund.

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Are Hedge Funds and Private Equity Firms Next?

- Industry sweeps – e.g., oil and gas, pharmaceutical and medical device, telecommunications industries.
- "The FCPA Unit will continue to focus on industry-wide sweeps, and no industry is immune from investigation."
- January 2011 – SEC letters to 10 financial institutions, including US-based banks, hedge funds and private equity firms, re: relationship with sovereign wealth funds.
- November 2012: "A Resource Guide to the US FCPA" – banking and finance sector identified as one of the industries the DOJ and SEC will focus on.

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Overview of the FCPA

U.S. Foreign Corrupt Practices Act

ANTI-BRIBERY PROVISIONS

Prohibit bribery of foreign government or political officials for the purpose of obtaining or retaining business or securing any improper business advantage

BOOKS & RECORDS PROVISIONS

Require SEC-registered or reporting issuers to make and maintain accurate books and records and to implement adequate internal accounting controls

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To Whom Do the FCPA Antibribery Provisions Apply?

- Any "**issuer**" that files reports with the SEC or trades equity or debt on a U.S. exchange
  - Includes foreign companies that trade, for example, American Depositary Receipts (ADRs)
- Any "**domestic concern**"
  - Includes U.S. citizens, nationals, and residents, as well as any entity that is organized under the laws of the US or that has its principal place of business in the US
- Any "**person**," including an individual or organization, wherever located, that, while in the US, does any act in furtherance of the prohibited conduct
  - Acts "in the U.S." include: *e.g.*, e-mails routed through U.S. servers, telephone calls to or from U.S., use of ISPs based in U.S., transfers through accounts in U.S. banks, finances of foreign subsidiary consolidated to books of U.S. parent company

Anti-Bribery Provisions

- It is unlawful for:
  - an issuer, domestic concern, or anyone acting within the jurisdiction of the United States
  - with “corrupt intent”
  - to directly or indirectly
  - offer, pay, promise to pay, or authorize payment of
  - “anything of value”
  - to a “foreign official”
  - for the purpose of obtaining or retaining business or securing any improper advantage

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“Corrupt Intent”

- Corrupt intent is required
- Goal of payment is to secure or retain improper business advantage
  - – Payment need not be quid pro quo for a specific contract
  - – Size of payment does not matter
  - – Actor need not know the identity of the recipient
  - – Prohibited payments include:
    - Payments intended to influence an act, decision, or omission to act by a foreign official

“Knowing”

- Payment must be made “knowing” that some or all of it will be offered or given to a foreign official
- “Knowledge” includes actual knowledge as well as “should have known,” based on:
  - “conscious disregard”
  - “willful blindness”
- FCPA’s knowledge standard was drafted broadly to address the “head-in-the-sand” scenario
- Inadequate compliance programs or controls can be basis for inference of “knowledge”

“Limits” of Knowledge and Intent

- United States v. Bourke
  - Co-investors in Azeri investment deal
  - Bourke did not pay or authorize the payment of bribes
  - The government argued that he knew or should have known his co-investor was paying bribes to foreign officials
  - Willful blindness was sufficient to support a conviction
    - *Juror: “We thought [Bourke] knew [about the bribery] and definitely could have known. He’s an investor. It’s his job to know.”*
  - Sentenced to one year and one day and fined $1 million

Direct or Indirect Payments Are Covered

- Statute prohibits unlawful payments directly or indirectly through a third party
- NO immunity by doing business through foreign affiliates, foreign subsidiaries or third parties
- MOST recent FCPA enforcement cases involve indirect payments -- actions are based on conduct engaged in by various third parties on behalf of a company
- Examples of third parties through whom illegal payments made:
  - Third party finders/brokers
  - Placement agents
  - “Fixers”
  - Consultants
  - Partners or joint ventures
  - Lawyers/Accountants

What Qualifies as “Anything of Value”

- “Anything of Value” = *Any Benefit*
- Examples include but are not limited to:
  - Gift cards, coupons and vouchers
  - Gifts with more than nominal value
  - Entertainment or travel
  - Scholarships, school placements
  - Loans on favorable terms
  - Allocations of shares
  - Contributions to political parties, causes, candidates, and officials
  - Contributions to official’s pet charity
  - Loan of a vacation home, automobile, or yacht, etc.
  - Jobs or internships for family or friends of a foreign official

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"Foreign Official"

- Defined *very broadly* – statutory definition includes:
  - Foreign government employees or officials
  - Political officials or members of their staffs
  - Employees of public international organizations (e.g., UN, World Bank)
  - Candidates for political office
  - Includes officers or employees of a department, agency or instrumentality of a foreign government
    - *State-controlled or state-owned enterprises (SOEs) – e.g., sovereign wealth funds, banks, brokerage firms,*
    - *Factors to be considered in determining whether agency or instrumentality of foreign government*

What Is an “Unfair” Business Advantage?

- Focus is on gaining or retaining an “unfair” competitive business advantage
  - Examples include payments intended to:
    - *Encourage investment (e.g., from a sovereign wealth fund)*
    - *Influence legislation*
    - *Create general goodwill toward the company through regular gifts or entertainment*
    - *Obtain needed licenses or certifications*
    - *Obtain favorable tax treatment*
    - *Expedite customs clearance or avoid customs and tax duties or penalties*
- The bribe does NOT need to be successful

Exception to Anti-bribery Provisions

- Facilitation or "grease" payments
  - Exception has limited application
  - Payment by a foreign official to expedite or secure the performance of routine governmental actions
  - Applies only to non-discretionary actions by a foreign official, such as processing government paperwork or providing routine government services
    - *e.g., police protection, stamping passports*
  - Caveat: Not always legal under local law

Affirmative Defenses

- Promotional payments
  - Reasonable and bona fide expenses and directly related to
    - *the promotion, demonstration, or explanation of products or services; or*
    - *the execution or performance of a contract*
  - Proper documentation of expenditures
- Payments that are lawful under the written laws of the foreign country

FCPA Fines, Penalties and Collateral Consequences

- Criminal fines and civil penalties
- Prison
- Disgorgement
- Rescission of Contracts, Permits
- Reputational Damage
- Deferred Prosecution Agreements
- Compliance monitors

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Potential FCPA Fines and Penalties

Business Organizations

- Accounting violations:
  - $25 million criminal fine per violation
  - $500,000 civil penalty
- Anti-bribery violations:
  - Up to $2 million criminal fine per violation
  - $10,000 civil penalty or disgorgement of gross gain
  - Alternative Fines Statute – twice the gain or loss

Individuals

- Accounting violations:
  - 20 years in prison and/or $5 million per violation
  - $100,000 civil penalty
- Anti-bribery violations:
  - 5 years in prison and/or $250,000 per violation
  - $10,000 civil penalty or disgorgement of gross gain
  - Alternative Fines Statute – twice the gain or loss

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Hedge Funds and the Fearsome FCPA

Case Examples

- Omega Investors
  - Hedge fund itself not involved in any bribes, but former partner at Omega knew of bribes
  - Omega lost all of its $100M investment
  - To date, no privatization has occurred
  - NPA and $500K fine
- Franciso Illarramendi – MK Capital Management
  - MK funded through large-scale investments by pension funds of PDVSA
  - Investments obtained by making significant bribes
  - Hedge fund later revealed to have been a Ponzi scheme

FCPA Risks for Hedge Funds

- Direct Liability for Violation of Anti-Bribery Provisions
  - Inbound investment risks
  - Outbound investment risks
- Liability for Acts of Third Party Agents or Intermediaries
- Liability for Actions of Portfolio Companies or Joint Ventures
- Economic Risks from an Investment Perspective

Direct Liability – Inbound Investments

- Beware with whom you curry favor to solicit investments
  - Sovereign wealth funds
  - Foreign pension funds
  - Large institutional investors
  - Foreign officials?
- Enticements to invest may violate the FCPA
- Francisco Illarramendi: How did he get the money?

Direct Liability – Outbound Investments

- Interest in emerging markets
- But … challenge to gain access to business and investment opportunities in countries with higher rates of public corruption
- Often must work through foreign government officials
- Resist the temptation to provide a “gift” to facilitate an investment opportunity

Liability for the Acts of a Third Party

- Main FCPA risk is presented by foreign investment through the use of third-party agents or intermediaries
- Fast growing but underdeveloped economies may make attractive investment opportunities
- They also may present a bureaucratic nightmare of red tape and corrupt officials
- May retain local agents or “fixers”
- Third party agents may corruptly offer improper gifts, commissions, items of value to government officials to obtain or retain business

Liability for the Acts of Portfolio Companies or JVs

- Traditional agency principles apply
  - Ownership or control could result in imputed liability
  - *Respondeat superior*
- Joint venture
  - Activities of JV imputed to each member irrespective of the member's ownership status, as long as sufficient "knowledge" of activity
- Successor Liability
  - Acquiring a company that violated the FCPA prior to acquisition could expose the fund to civil and criminal FCPA liability

Economic Risk

- Size of FCPA penalties
- Tremendous costs and expenses in responding to an FCPA investigation
- Practical issues – effect on valuation of portfolio company

Morgan Lewis

Managing the Risks and Protecting the Fund

Effective FCPA Compliance Program

- No one-size-fits-all compliance program
- Risk assessment to gauge the fund’s needs
- Implement, review and assess own internal FCPA compliance programs
- Ensure that effective FCPA programs are in place not only in-house but also at portfolio companies

Elements of an Effective Compliance Program

- Strong “tone at the top” prohibiting corrupt activities
- Clearly written policies and internal controls
- Training and education
- Effective reporting structure for misconduct
- Enforcement
- Due diligence
- Third-party policies
- Compliance monitoring
- Addressing potential FCPA violations

Compliance Auditing of Portfolio Companies

- Questions to consider in conducting the audit:
  - Does the company operate in a high-risk industry?
  - Does the company operate in a high-risk country?
  - Does the company have connections with foreign officials?
  - Has due diligence been performed on the company and its business partners, agents and other third parties?
  - Are there any red flags in the company's business dealings?
  - Does the company have past or present FCPA issues?
  - Does the company have an effective FCPA compliance program?

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Due Diligence

Third-Party Due Diligence

- **Understand** how the third party was identified or recommended
- **Know** your business partners, agents and consultants
- **Know** your exposure to, or contacts with, foreign government officials (including employees of state-owned businesses)
- **Understand** the services to be provided and how the payment will be made
- **Conduct** a “red-flag” analysis

Morgan Lewis

Tools for Due Diligence and Contracting

- New agent application
- New agent questionnaire
  - Basic information about the company
  - Questions about areas that present known FCPA risks
- Follow-up by legal or compliance personnel
- Additional due diligence regarding red flags
- Written agreement
  - Specific anti-corruption safeguards
  - Audit rights
  - Agreements and certifications

Pre-Investment Due Diligence – Recommended Steps

- Identify and review publicly available information
- Review due diligence materials
- Request that target complete a due diligence questionnaire
- Engage a third party investigation firm to review for “red flag” issues
- Consider in-person interviews with key owners, officers, and personnel
- Request that key owners, officers, and personnel complete compliance certifications
- Consider closing conditions

Evaluating Historic and Future Compliance with the FCPA

- Risks associated with country location and/or specific industry
- Prior investigations about or convictions of violations of the FCPA or other anti-corruption laws
- Ownership and management structure
- Business dealings with government entities or individuals with connections with government
- Necessary government authorizations and process to secure such approvals
- Reliance on third party agents and selection and monitoring processes
- Gifts and entertainment policy
- Anti-corruption policies and procedures and training

Post-Investment Diligence

- Stay alert – new facts may warrant a re-evaluation of the pre-investment due diligence results
- Assure that the portfolio company implements its own adequate anti-corruption compliance program
- Standard fund-level policy
- Require investment and acquisition targets to conduct annual training
- Require yearly audits
- Compliance review of existing portfolio companies

international presence

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Thomas V. D'Ambrosio is a partner in Morgan Lewis's Business and Finance Practice. Mr. D'Ambrosio focuses his practice on structured and complex derivative transactions and insolvency and regulatory matters relating to such structures for Fortune 500 corporations, private companies, hedge funds, financial institutions, pension funds, and high-net-worth individuals. He regularly assists those clients in connection with structuring, negotiating, and analyzing the risk inherent in a wide range of derivative products, including equity, debt, credit, commodity, interest rate, and currency derivatives. He is particularly active in using derivatives to aid clients in hedging risks, monetizing assets, and acquiring and financing the acquisition of assets on favorable terms (both with and without the benefits of leverage), including the financing of equity and debt repurchase programs of issuers. He is actively representing clients on Dodd-Frank derivative reform.

Mr. D'Ambrosio also has extensive experience representing issuers in connection with public and private sales of equity and debt securities. He has advised purchasers and sellers in stock sales, asset sales, and merger transactions; he has advised investment managers in connection with leveraged hedge fund investments; and he has counseled pension funds and wealthy families with respect to their investments in hedge funds.

Prior to joining Morgan Lewis, Mr. D'Ambrosio was a partner in the corporate practice of an international law firm in New York.

Mr. D'Ambrosio received his J.D., cum laude, from Cornell Law School in 1991, where he was a member of the *Cornell International Law Journal*. He received his B.A., magna cum laude, in English and history from Amherst College in 1988.

Mr. D'Ambrosio is admitted to practice in New York and New Jersey and before the U.S. Supreme Court, the U.S. District Courts for the Northern, Eastern, Southern, and Western Districts of New York, and the U.S. District Court for the District of New Jersey.

practice areas

- Business & Finance
- Securities Industry
- Mergers & Acquisitions
- Corporate Finance
- Derivatives
- Joint Ventures & Strategic Alliances
- Finance
- Energy Transactions
- Commodities, Futures, Foreign Exchange, & Energy Trading
- Private Investment Funds
- Financial Services

bar admissions

- New York
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court admissions

- U.S. Supreme Court
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practice accolades

Private Investment Funds

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honors + affiliations

Appointed Chairman, New York City Bar Association Committee on Futures and Derivatives Regulation (three year term commencing 2012)

Member by appointment, New York City Bar Association Futures and Derivatives

Regulation Committee (2009-2012)

Member, New York City Bar Association

Listed, *The Best Lawyers in America* (2009–2012)

Listed, *New York Super Lawyers* (2010–2012)

Listed, *The Legal 500* (2008, 2009, 2011–2012)

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Christopher J. Dlutowski is of counsel in Morgan Lewis's Business and Finance Practice and is a member of the firm's Private Investment Funds Practice. Mr. Dlutowski represents private investment funds and investment management firms on fund structuring and formation, trading and other investment activities, capital raising, and ongoing operations. These funds include domestic and offshore hedge funds, private equity funds, and funds-of-funds. Mr. Dlutowski also represents institutional investors on their investments in private funds. He advises clients on registration and other regulatory issues under the federal securities and commodities laws.

Mr. Dlutowski was previously vice president and corporate counsel in the Public Equity and Fixed Income Law unit of Prudential Financial, Inc., where he advised investment management clients on their hedge funds and other alternative investment products, domestic and foreign institutional investor mandates, trading activities (including securities, derivatives, lending, and financing transactions), marketing efforts, and domestic and foreign registration and other regulatory issues.

Mr. Dlutowski received his J.D./M.S.F.S., a joint degree in law and foreign service, from Georgetown University Law Center in 1993, where he was a Ford Foundation Fellow. He received his M.Phil. in international relations from the University of Cambridge in 1989 and his B.A., with distinction, history, from the University of Pennsylvania in 1988.

Mr. Dlutowski is admitted to practice in New York.

practice areas

Business & Finance
Private Investment Funds
Investment Management
Investment Advisers
Mergers & Acquisitions
Cross-Border M&A

bar admissions

New York

practice accolades

Private Investment Funds

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

education

Georgetown University Law Center, 1993, J.D./M.S.F.S.

University of Cambridge, 1989, M.Phil.

University of Pennsylvania, 1988, B.A., Distinction

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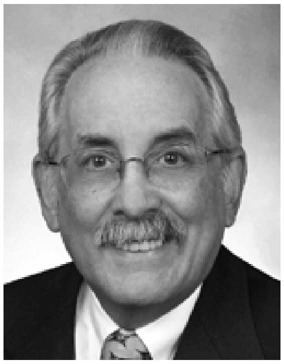

practice areas

Investment Management

Securities Industry

Compliance & Investment Management

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Broker-Dealer & Capital Markets Regulation

Exchange Traded Funds

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Mark D. Fitterman is a partner in Morgan Lewis's Investment Management and Securities Industry Practice. Mr. Fitterman's practice focuses on the regulation of broker-dealers under federal and state law.

Mr. Fitterman counsels clients on a wide variety of regulatory and compliance matters, including trading and execution issues, federal and state registration and compliance issues; SEC, NYSE, NASD and state examinations, investigations and enforcement actions; development of new products and services; regulation of alternative trading systems; insider trading and market manipulation issues; best execution issues; Internet trading and on-line brokerage; interpretive and “no-action” requests; and related matters.

Prior to joining the firm, Mr. Fitterman was Associate Director of the SEC’s Division of Market Regulation and Office of Compliance Inspections and Examinations, where he was responsible for the inspection and oversight for the nation’s stock and options markets, including sales practice compliance, insider trading, market surveillance, enforcement, arbitration and listing. Mr. Fitterman was also responsible for nation-wide coordination of the SEC’s broker-dealer examination program and served as liaison to the SEC’s Division of Enforcement and the North American Securities Administrators Association on matters involving securities markets and broker-dealer regulation.

Mr. Fitterman is admitted to practice in the District of Columbia and Ohio.

practice accolades

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

honors + affiliations

Recipient, Presidential Rank Award--Distinguished Executive

Recipient, SEC’s Distinguished Service Award

education

Georgetown University Law Center, 1974, J.D.

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Anne C. Flannery is a senior counsel in Morgan Lewis's Litigation Practice. Her practice focuses on a variety of securities enforcement and litigation matters, including investigations by the U.S. Securities and Exchange Commission (SEC), FINRA and state securities regulators for potential securities fraud, trading and sales practice violations and related supervisory issues.

Ms. Flannery has handled numerous complex matters on behalf of financial institutions, public companies, and individuals in investigations and litigation with securities regulators, including contested hearings and appeals. Ms. Flannery also has extensive experience in conducting internal investigations, counseling broker-dealers on regulatory and compliance issues, acting as an independent consultant to firms and representing clients in general federal civil litigation and white-collar criminal defense matters relating to securities issues.

Ms. Flannery originally joined Morgan Lewis in October 1987 after a successful career as a senior official in the SEC 's Washington, D.C. and New York offices. As a Morgan Lewis partner in the firm's securities practice, she achieved significant success for clients, while also serving on the Governing Board of the firm for several years. In 1999, Ms. Flannery left Morgan Lewis to join Merrill Lynch's Office of General Counsel. At Merrill, she held several senior positions, including First Vice President and General Counsel for Global Regulatory Affairs. During part of her tenure at Merrill Lynch, Ms. Flannery also served as the global head of compliance.

Ms. Flannery writes and lectures frequently on regulatory and enforcement issues. She is co-chair of the SRO Subcommittee of the ABA Litigation Section Securities Committee, former co-chair of the ABA Securities Litigation Committee, a former member of the NYSE Legal Advisory Committee, the NASD Membership Committee, and the SIA Compliance and Legal Division Executive Committee. While at the SEC, she was a recipient of both the Irving M. Pollack Award and a Distinguished Senior Executive Service Award.

Ms. Flannery is a cum laude graduate of both Brooklyn Law School and Marymount Manhattan College. She is a past chair and current trustee of the Board of Trustees for Marymount Manhattan College.

Ms. Flannery is admitted to practice in New York.

practice areas

- Litigation
- Broker-Dealers
- Securities Regulation
- Investment Management
- Anti-Money Laundering
- Securities Litigation & Enforcement
- FCPA/Anticorruption
- Broker-Dealer & Capital Markets Regulation
- Exchange Traded Funds
- Financial Services
- Registered Investment Companies

bar admissions

New York

honors + affiliations

Listed, *Chambers USA: America's Leading Lawyers for Business* (2009–2012)

Co-Chair, SRO Subcommittee, ABA Litigation Section Securities Committee

Former Co-Chair, ABA Litigation Section Securities Litigation Committee

Former Member, NYSE Legal Advisory Committee

Former Member, NASD Membership Committee

Former Member, SIA Compliance and Legal Division Executive Committee

Recipient, SEC Irving M. Pollack Award

Recipient, SEC Distinguished Senior Executive Service Award

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Brooklyn Law School, 1976, J.D., Cum Laude

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Ivan P. Harris is a partner in Morgan Lewis's Litigation Practice. Mr. Harris represents public companies and their employees, financial institutions, securities industry professionals, and other entities and individuals in investigations, examinations, and litigation before the SEC, FINRA, NYSE, and other securities regulators. He also regularly advises securities industry clients on compliance and regulatory issues. Mr. Harris's background includes senior positions at the SEC and a position as in-house counsel at a financial services firm. From 2001 to 2005, he was an assistant regional director for enforcement in the SEC's Miami Office, which he joined in 1998.

Since joining the firm, Mr. Harris has represented hedge fund and securities industry clients with respect to regulatory investigations and examinations involving asset-backed and mortgage-backed securities, auction rate securities, and hedge fund and mutual fund valuation practices. He has also represented public companies and their officers and directors in SEC investigations involving financial accounting practices and insider trading. Additionally, Mr. Harris counsels clients on a variety of Foreign Corrupt Practices Act (FCPA) related issues, including investigations, due diligence, and training.

While at the SEC, Mr. Harris led an SEC investigation of a major hedge fund collapse and an investigation of the first SEC case involving illegal hedge fund short selling. He also developed a background in international securities cases, having investigated major accounting, financial disclosure, stock manipulation, and Foreign Corrupt Practices Act (FCPA) matters with connections to Europe and Latin America.

Immediately prior to joining Morgan Lewis, Mr. Harris served as the regulatory counsel for a financial services firm, where he advised on trading issues and compliance matters pertaining to the firm's hedge fund and broker-dealer operations. He also served on several securities industry committees that focused on issues relevant to fixed income trading and securitized products.

Mr. Harris is a frequent speaker at securities industry and hedge fund conferences. Before joining the SEC in 1998, he practiced in the litigation departments of two New York law firms. Mr. Harris is admitted to practice in Florida and New York and before the U.S. District Court for the Southern District of Florida.

practice accolades

Private Investment Funds

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practice areas

Litigation
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Securities Litigation & Enforcement
Investment Management
Broker-Dealer & Capital Markets Regulation
Private Investment Funds
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Accounting Litigation
FCPA/Anticorruption
Financial Services

bar admissions

Florida
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court admissions

U.S. District Court for the Southern District of Florida

honors + affiliations

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Duke University School of Law, 1994, J.D.

University of Pennsylvania, Wharton School of Business, 1991, B.S., Cum Laude

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Will Iwaschuk is a partner in Morgan Lewis's Investment Management and Securities Industry Practice. Mr. Iwaschuk has experience in equity derivatives and equity sales and trading. He has advised OTC derivatives businesses in structuring, marketing, and trading delta-one and volatility derivatives in the equities space. He has also advised market makers, specialists, and liquidity providers in trading equity stocks, options, and exchange-traded funds (ETFs) on exchanges. Since the financial crisis of 2008, he has been heavily involved in cross-asset regulatory reform activities, particularly in matters involving Title VII of the Dodd-Frank Act and the Volcker Rule.

Prior to joining Morgan Lewis, Mr. Iwaschuk was a vice president and associate general counsel at Goldman, Sachs & Co. Prior to his in-house work, Mr. Iwaschuk was an associate in the equity derivatives group at another international law firm.

Mr. Iwaschuk earned his LL.B. from the University of British Columbia Faculty of Law in 2002 and his B.A. from the University of British Columbia in 1999.

Mr. Iwaschuk is admitted to practice in New York.

practice accolades

Investment Management

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Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

education

University of British Columbia Faculty of Law, 2002

University of British Columbia, 1999, B.A.

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Ethan W. Johnson is a partner in Morgan Lewis's Investment Management and Securities Industry Practice. Mr. Johnson's practice focuses on investment management; banking and financial institution law; international corporate finance; mergers and acquisitions; corporate governance; and general corporate law. Mr. Johnson counsels clients on a wide variety of regulatory and transactional matters, including the creation of hedge funds, private equity funds, venture capital funds, real estate funds, UCITS and SEC-registered funds; the organization and operation of broker-dealers and investment advisers; corporate finance projects including public and private offerings of debt and equity issues; and joint venture and investment projects in Latin America, Europe and Asia.

Mr. Johnson is a frequent author and lecturer on various topics, most recently including, regulation of broker-dealers and investment advisers; global distribution of investment funds; private equity real estate funds; and investment in the Emerging Markets and corporate governance. He is an editor of the *Morgan Lewis Hedge Fund Deskbook: Legal and Practical Guide for a New Era*, published by Thomson Reuters/West.

Mr. Johnson is admitted to practice in Florida and New York.

practice areas

Investment Management

Registered Investment Companies

Investment Advisers

Broker-Dealers

Securities Industry

Real Estate Funds

Mergers & Acquisitions

Real Estate Investment Trusts

Real Estate Capital Markets

Broker-Dealer & Capital Markets Regulation

Private Investment Funds

Exchange Traded Funds

Latin America

Commodities, Futures, Foreign Exchange, & Energy Trading

Financial Services

Global Financial Services & Compliance

Bank Regulatory

bar admissions

Florida

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practice accolades

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

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Private Investment Funds

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

honors + affiliations

Member, American Bar Association

Member, Inter-American Bar Association

Listed, *The Best Lawyers in America* (2007–2011)

Listed, Investment Fund Formation and Management: Alternative/Hedge Funds in *The US Legal 500* (2009)

Listed, Investment Fund Formation and Management: Mutual Funds in *The US Legal 500* (2009)

AV Preeminent Peer-Review Rated by Martindale-Hubbell

Listed, "Top Lawyers," Investment Management & Banking and Financial Institutions, *South Florida Legal Guide* (2005–2012); Legal Elite Section recognition, *Florida Trend Magazine* (2004–2008)

Listed, *Florida Super Lawyer* (2006, 2008–2009)

Listed, *The International Who's Who of Private Funds Lawyers* (2006, 2011)

Managing Editor, *Emory University Law Journal*

education

Emory University School of Law, 1985, J.D.

Harvard University, 1979, B.A.

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Jennifer L. Klass is a partner in Morgan Lewis's Investment Management and Securities Industry Practice. Ms. Klass advises investment managers and broker-dealers on a broad range of regulatory matters.

Ms. Klass has counseled compliance and business personnel on legal and regulatory matters associated with high-net-worth brokerage and asset management business, including SEC examinations and self-regulatory organization sweeps; wrap fee and other separately managed account programs; electronic delivery and online brokerage services; private banking; new products; account opening and the application of broker-dealer and investment adviser registration to non-U.S. affiliates.

Prior to joining Morgan Lewis, Ms. Klass was vice president and associate general counsel at Goldman, Sachs & Co., where she advised the private wealth management and asset management business. She previously served as an Investment Management associate in the Washington, D.C. office of Morgan Lewis.

Ms. Klass received her J.D. from Widener University School of Law in 1997 and her B.A. from Lehigh University in 1992.

Ms. Klass is admitted to practice in New York, the District of Columbia, and Pennsylvania.

practice areas

Investment Management
Securities Industry
Broker-Dealers
Wrap Fee Sponsors
Investment Advisers
Broker-Dealer & Capital Markets Regulation
Exchange Traded Funds
Financial Services
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bar admissions

New York
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practice accolades

Investment Management

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honors + affiliations

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Widener University School of Law, 1997, J.D.

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practice areas

Investment Management

Compliance & Investment Management

Registered Investment Companies

Investment Advisers

Securities Industry

Private Investment Funds

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Timothy W. Levin is a partner in Morgan Lewis's Investment Management and Securities Industry Practice. Mr. Levin's practice focuses on investment company matters, private fund organization and management, as well as investment adviser regulation. Mr. Levin represents many types of registered investment companies, such as mutual funds, closed-end funds and registered funds of hedge funds, and managers of registered investment companies in connection with organization, registration and ongoing regulatory compliance. He also represents unregistered pooled investment vehicles, including managers and sponsors of private funds, and companies seeking exemption from investment company status.

Mr. Levin is listed in *Chambers USA: America's Leading Lawyers for Business* and is recognized by *Chambers* as a young partner who is "rising to the top" when it comes to providing client service.

Mr. Levin is an editor of the *Morgan Lewis Hedge Fund Deskbook: Legal and Practical Guide for a New Era*, and the *Mutual Fund Regulation and Compliance Handbook*, 2008–2009 Edition, both published by Thomson Reuters/West.

Prior to joining Morgan Lewis, Mr. Levin served as a law clerk for Judge Stephen J. McEwen, Jr., of the Superior Court of Pennsylvania, from September 1995 to July 1996.

Mr. Levin is admitted to practice in Pennsylvania and New Jersey.

practice accolades

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Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

Private Investment Funds

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

honors + affiliations

Listed, *Chambers USA: America's Leading Lawyers for Business* (2008–2012)

Listed, Investment Fund Formation and Management: Mutual Funds in *The US Legal 500* (2009–2010)

education

Villanova University School of Law, 1995, J.D.

University of Pennsylvania, 1992, B.A.

Morgan Lewis

practice areas

Investment Management

Securities Industry

Securities Litigation & Enforcement

Broker-Dealers

Financial Services M&A

Broker-Dealer & Capital Markets Regulation

Exchange Traded Funds

Commodities, Futures, Foreign Exchange, & Energy Trading

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Private Investment Funds

Financial Services

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Robert C. Mendelson is a partner in Morgan Lewis's Investment Management Practice and a member of the firm's Financial Services Transactions Group. Mr. Mendelson is a recognized authority on securities law, having served on the blue-ribbon IPO Process Committee and on the NASD's Corporate Finance Committee. Mr. Mendelson's practice focuses on securities and derivatives markets, broker-dealer regulation and enforcement defense, public offerings, and private placements. He handles all aspects of broker-dealer regulation, representing bulge bracket investment banks in derivatives and securities trading as well as securities offerings and general commercial issues.

Mr. Mendelson is listed in *The Best Lawyers in America*, *The Legal 500 US*, and *Chambers USA: America's Leading Lawyers for Business*. *Chambers* lists Mr. Mendelson as one of the leading lawyers for investment management and also notes his "substantive experience and measured judgment" when dealing with clients.

Mr. Mendelson is on the faculty of the NASD Institute and is a frequent speaker on topics in the Securities laws, giving more than eight speeches annually.

Mr. Mendelson is admitted to practice in New York.

practice accolades

Investment Management

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Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

Private Investment Funds

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honors + affiliations

Member, IPO Process Committee of NASD and NYSE

Member, National Association of Securities Dealers, Corporate Finance Committee

Former Member, National Association of Securities Dealers, Legal Advisory Board

Former Chair, Securities and Exchange Commission, Market Transaction Advisory Committee

Former Chairman, American Bar Association, Business Law Section, Investment Securities of the Uniform Commercial Code Committee Subcommitte

Member, American Bar Association, Settlement of Market Transactions, Advisory Committee

Listed, *Chambers USA: America's Leading Lawyers for Business* (2006–2012)

Listed, *The Best Lawyers in America* (2007–2011)

education

Boston College Law School, 1980, J.D.

Brandeis University, 1973, M.A.

Rice University, 1972, A.B.

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Michael M. Philipp is a partner in Morgan Lewis's Investment Management and Securities Industry Practice. Mr. Philipp represents financial services clients in futures and securities transactions and in derivatives regulation, legislation, compliance, and enforcement matters.

Mr. Philipp serves as counsel to domestic and foreign exchanges and clearing organizations, banks, investment managers, brokerage firms, and end-users in connection with exchange-traded and over-the-counter derivative instruments. He has represented foreign exchanges and clearing houses in their U.S. offerings of futures and equity options products and derivatives clearing activities.

Prior to joining Morgan Lewis, Mr. Philipp was a partner at an international law firm, resident in Chicago. He was also previously an in-house attorney for the Chicago Mercantile Exchange, where he served as counsel to the Exchange's regulatory trade practice, compliance, and arbitration committees.

Mr. Philipp received his J.D. from DePaul University College of Law in 1992 and his B.A., with honors, in Near Eastern languages and civilizations from the University of Chicago in 1981.

Mr. Philipp is admitted to practice in Illinois and before the U.S. District Court for the Northern District of Illinois.

practice areas

- Investment Management
- Securities Industry
- Broker-Dealers
- Derivatives
- Broker-Dealer & Capital Markets Regulation
- Exchange Traded Funds
- Commodities, Futures, Foreign Exchange, & Energy Trading
- Financial Services

bar admissions

Illinois

court admissions

U.S. District Court for the Northern District of Illinois

practice accolades

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

honors + affiliations

Listed, *The Best Lawyers in America* (2007–2012)

Member, Federal Reserve Bank of Chicago's Working Group on Financial Markets

Board Member, The Ark

Former Member, Chicago Mercantile Exchange and Chicago Board of Trade Business Conduct and Probable Cause Committees

Program Chair, American Bar Association, Futures and Derivatives Law Committee Winter Meeting (2005)

Former Chair, Chicago Bar Association, Futures and Derivatives Law Committee

Former Member, Executive Committee of the Futures Industry Association Law and Compliance Division

education

DePaul University College of Law, 1992, J.D.

University of Chicago, 1981, B.A., With Honors

Morgan Lewis

Michael A. Piracci

of counsel

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Michael A. Piracci is of counsel in Morgan Lewis's Investment Management and Securities Industry Practice. Mr. Piracci focuses his practice on exchange traded futures, foreign exchange, and matters related to futures commission merchants, introducing brokers, commodity pool operators, and commodity trading advisors. He provides advice and counsel relating to a broad range of regulatory issues, including compliance under the Commodity Exchange Act, regulatory examinations, and trading and market practices.

Prior to joining Morgan Lewis, Mr. Piracci served as a senior attorney at the National Futures Association (NFA), the industrywide self-regulatory organization for the U.S. futures industry. He also served as the associate director in charge of the New York office of NFA. In that role, Mr. Piracci was responsible for the regulatory oversight of all NFA members in the northeast region, including futures commission merchants, introducing brokers, commodity pool operators, and commodity trading advisors.

Mr. Piracci previously was an associate in Morgan Lewis’s Investment Management Practice. He also served as an attorney advisor of the Commodity Futures Trading Commission’s (CFTC's) Division of Clearing and Intermediary Oversight. As an attorney advisor, he drafted rules that affected all classes of intermediaries. He was involved in developing and drafting rules regarding the holding of customer funds in non-U.S.-denominated currencies and the implementation of online registration for all classes of intermediaries.

Mr. Piracci has spoken on numerous industry panels regarding regulatory compliance with CFTC and NFA rules.

Mr. Piracci received his J.D. from Hofstra University School of Law in 1999 and his B.A. from the State University of New York at Buffalo in 1996.

Mr. Piracci is admitted to practice in New York, the District of Columbia, and Illinois.

practice areas

Investment Management

Securities Industry

Broker-Dealers

Commodities, Futures, Foreign Exchange, & Energy Trading

bar admissions

New York

District of Columbia

Illinois

practice accolades

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

honors + affiliations

Chair, Chicago Bar Association's Futures and Derivatives Law Committee (2008–2009)

education

Hofstra University School of Law, 1999, J.D.

State University of New York at Buffalo, 1996, B.A.

Morgan Lewis

Louis H. Singer

partner

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Louis H. Singer is a partner in Morgan Lewis's Business and Finance Practice and head of the firm's Private Investment Funds Practice. Mr. Singer's clients include many of the most significant pension funds, life insurance companies, alternative investment managers, universities, and family offices.

Mr. Singer represents domestic and international clients in regard to virtually every type of private investment fund, including buyout, venture capital, real estate, corporate governance, hedge, distressed assets, energy, infrastructure, and mezzanine funds. He has an extensive background in the formation of funds-of-funds and co-investment funds and in their investment activities.

Mr. Singer's practice also focuses on the representation of institutional investors in direct debt and equity investments, including the purchase of senior and subordinated notes, mezzanine investments, buyouts, venture capital investments, secondary transactions, and structured financings. He has represented life insurance companies, pension funds, and other financial institutions for over 30 years.

Mr. Singer served on the firm's Advisory Board Committee and currently is a member of the firm's Compensation Committee. Mr. Singer also served as a trustee of the American College of Investment Counsel for nine years and as president of that organization. He also served for four years as a member of the board of governors of the Association of Life Insurance Counsel. He currently serves as Chair of the Private Investment Funds Forum.

Mr. Singer's recent speaking engagements have included presentations to the Dow Jones Private Equity Analyst Limited Partners Summit, the National Association of Public Pension Attorneys, the International Bar Association, Wharton Private Equity Partners, SuperReturn USA, the Institute for Private Investors, the New York City Bar Association, the American College of Investment Counsel, and the Association of Life Insurance Counsel. Mr. Singer is listed in numerous directories, including *Chambers USA: America's Leading Lawyers for Business* and *The Best Lawyers in America*.

In 2006, Mr. Singer was named by *Private Equity International* as one of the 30 most influential private equity lawyers in the world.

Mr. Singer is admitted to practice in New York only.

practice areas

Business & Finance
Private Investment Funds
Private Equity
Investment Management
Financial Services

bar admissions

New York

practice accolades

Private Investment Funds

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

honors + affiliations

Listed, *Chambers USA: America's Leading Lawyers for Business* (2004–2012)

Listed, *Chambers Global: The World's Leading Lawyers* (2007–2012)

Listed, *The Best Lawyers in America* (2005–2011)

Listed, "Guide to the World's Leading Investment Funds Lawyers," *International Financial Law Review/Expert Guides* (2008–2010)

Listed, *New York Super Lawyer*

Listed, Investment Fund Formation and Management: Private Equity Funds and Investment Fund Formation and Management: Venture Capital Funds, *The US Legal 500* (2009–2012)

Former President, American College of Investment Counsel

Former Member, Board of Governors, The Association of Life Insurance Counsel

Member, Private Investment Funds Forum

Member, National Association of Public Pension Attorneys

Editorial Board Member, *Stanford Law Review*

Recipient, Cambridge College Prize for Academic Excellence

Recipient, The Thouron Award for study in the United Kingdom

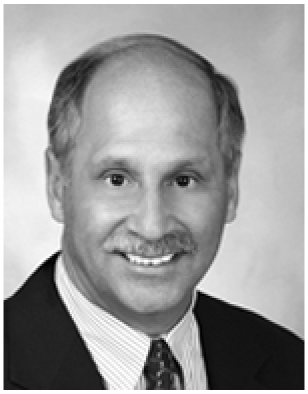
education

Stanford Law School, 1977, J.D.

Cambridge University, 1975, LL.B., First Class

University of Pennsylvania, 1973, B.A., Magna Cum Laude, Phi Beta Kappa

Morgan Lewis



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David A. Sirignano is a partner in Morgan Lewis's Securities Practice. Mr. Sirignano focuses on international and domestic corporate finance, structured finance, mergers and acquisitions, and SEC regulation. He is co-head of the firm's Securities Practice. Before joining the firm in Washington, he was Associate Director for International Corporate Finance in the SEC's Division of Corporation Finance. In that position, he developed SEC policy on cross-border offerings, acquisitions and listings, including offshore Internet offerings, international disclosure and accounting standards, as well as international corporate governance guidelines. He also advised the SEC and its Division of Enforcement on financial fraud cases and cross-border offering abuses.

Previously, Mr. Sirignano served as the SEC Senior Legal Advisor to the Director of the Division of Corporation Finance, and as Staff Director of the Advisory Committee on Capital Formation and Regulatory Processes. He also was Chief of the Division's Office of Tender Offers, administering rules on mergers and acquisitions, going private transactions and proxy contests.

Mr. Sirignano is a former Chair of the ABA Subcommittee on Corporate Disclosure. He has also served as a member of the FINRA Corporate Financing Committee. Mr. Sirignano is a frequent speaker at seminars, conferences and continuing legal education programs on international finance, Internet securities issues, corporate governance, mergers, acquisitions, restructurings and proxy contests. Mr. Sirignano was an adjunct professor at Georgetown University Law Center, where he taught a course on mergers and acquisitions.

Mr. Sirignano is admitted to practice in the District of Columbia and New York.

practice areas

- Business & Finance
- Securities Industry
- Going Private Transactions
- Public Companies
- Private Offerings
- Public Offerings
- Securities Regulation
- Corporate Governance
- Latin America
- Washington Government Relations & Public Policy
- Financial Services
- Broker-Dealers

bar admissions

- District of Columbia
- New York

honors + affiliations

Former Chair, Subcommittee on Public Company Disclosure and Continuous Reporting, Federal Regulation of Securities Committee (2001–2006)

Member, American Bar Association

Listed, *The Best Lawyers in America* (2006–2011)

education

Union University, Albany Law School, 1978, J.D.

Manhattan College, 1975, B.A.

Morgan Lewis

practice areas

Litigation

White Collar Litigation & Government Investigations

Qui Tam

FCPA/Anticorruption

bar admissions

New York

court admissions

U.S. Court of Appeals for the Second Circuit

U.S. District Courts for the Southern, Eastern, and Western Districts of New York

Martha B. Stolley

partner

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Martha B. Stolley is a partner in Morgan Lewis's Litigation Practice. Ms. Stolley focuses her practice on the representation of corporations and individuals in all aspects of white collar litigation, as well as regulatory enforcement matters and related civil litigation. She has represented clients in matters involving allegations of violations of the Foreign Corrupt Practices Act (FCPA), healthcare fraud, municipal bond fraud, securities fraud, insurance fraud, money laundering and structuring, environmental violations, and a variety of other offenses. Ms. Stolley routinely represents corporate and individual clients before the U.S. Department of Justice (DOJ), the U.S. Securities and Exchange Commission (SEC), the New York State Attorney General's Office, various District Attorneys' Offices and U.S. Attorneys' Offices, and other federal and state regulatory agencies.

Ms. Stolley also has experience conducting internal investigations and counseling clients on the development and implementation of internal compliance and ethics programs.

Prior to joining Morgan Lewis, Ms. Stolley was a senior trial attorney at the Manhattan District Attorney's Office. During her eight-year tenure at the D.A.'s Office, she presented hundreds of cases to the grand jury and successfully tried more than 30 jury trials in cases involving a wide range of serious crimes, including attempted murder, conspiracy to commit murder, narcotics trafficking, rape, sexual assault, felony assault, weapons possession, bank robbery, witness tampering, burglary patterns, robbery, criminal contempt, and vehicular homicide. Many of her cases were prominently featured in the press. In addition to her trial duties, Ms. Stolley served in the Sexual Crimes, Asian Gang, and Domestic Violence Units. She also participated in the office trial advocacy program and supervised many young lawyers in developing their trial skills.

Ms. Stolley earned her J.D., cum laude, from Northwestern University School of Law, where she served as the coordinating notes editor for *The Journal of Criminal Law and Criminology*.

Ms. Stolley is admitted to practice in New York and before the U.S. Court of Appeals for the Second Circuit and the U.S. District Courts for the Southern, Eastern, and Western Districts of New York.

selected representations

- Represented a Fortune 500 technology company in multi-country FCPA investigations involving related inquiries by the DOJ, the SEC, and the World Bank.
- Conducted FCPA and anti-corruption internal investigations in multiple countries on behalf of a Fortune 500 technology company.

- Represented a Fortune 500 retail pharmacy chain in connection with government, administrative, and civil investigations into billing practices and obtained favorable resolutions in multiple audits by the New York Office of the Medicaid Inspector General.
- Successfully defended a Fortune 500 retail pharmacy chain in an investigation by the New York Attorney General's Office into alleged violations of New York's General Business Law and health code provisions.
- Represented a Fortune 500 food services company in an investigation by the New York Attorney General's Office relating to alleged violation of state human rights laws in hiring practices, negotiated a favorable resolution and drafted a favorable monitoring plan.
- Represented a Fortune 500 food services company in sales tax investigations by the New York County District Attorney's Office and the New York State Department of Taxation and Finance.
- Investigated allegations of sexual harassment and abuse against a Fortune 500 food services company.
- Successfully defended an individual in a federal investigation into alleged money laundering and structuring.
- Investigated and successfully defended a hospital corporation in federal civil litigation involving allegations of breach of privacy and violations of the Health Insurance Portability and Accountability Act (HIPAA).
- Represented an individual against allegations of bid-rigging in the municipal finance industry.
- Investigated allegations of sexual abuse and misconduct by an employee of a major music conservatory.
- Successfully defended an FBI Special Agent in an investigation by the DOJ Office of Professional Responsibility (OPR).
- Represented a corporation and individuals in an SEC investigation into alleged bank fraud, accounting fraud, and violations of Sarbanes-Oxley.
- Represented a national infrastructure construction company in criminal and civil investigations by the district attorney's office and the New York Public Service Commission.
- Represented a worldwide education company in a long-term grand jury investigation into standardized testing security.
- Obtained an order securing the release from jail and dismissal of all charges against an individual serving a life sentence for a quadruple murder in Austin, Texas.

honors + affiliations

Member, American Bar Association

Member, New York City Bar Association

education

Northwestern University School of Law, 1998, J.D., Cum Laude

Northwestern University, B.A., With Honors

Morgan Lewis

practice areas

Business & Finance

Private Investment Funds

Investment Management

Investment Advisers

Exchange Traded Funds

Mergers & Acquisitions

Cross-Border M&A

Financial Services

bar admissions

New York

Jedd H. Wider

partner

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Jedd H. Wider is a partner in Morgan Lewis's Business and Finance Practice and a member of the firm’s Private Investment Funds Practice. Mr. Wider concentrates his practice in the structuring and formation of and investment in international and domestic private investment funds, particularly global hedge funds, private equity funds, secondary funds, real estate funds, mezzanine debt funds, venture capital funds and funds-of-funds and in the subsequent representation of these funds in their investment activities. He represents many of the world's leading financial institutions and investment banks as well as financial boutiques in their roles as sponsors, placement agents, and investment entities. He also has an extensive background in complex financial structurings and transactions and joint ventures.

Mr. Wider's views on the hedge fund and private equity fund industries and capital markets are frequently sought by members of the international media. His analysis can be found in publications such as *The Wall Street Journal, The Economist* and the *Financial Times,* as well as on television networks such as Bloomberg and CNN.

Mr. Wider also regularly lectures and serves as a panelist on private investment fund topics for trade programs and organizations. Recent speaking engagements include presentations to the International Bar Association's Annual International Conference on Private Investment Funds; Lazard Capital Markets Hedge Fund Conference: "The Changing Landscape of Investing in Single Manager Strategies"; Hedge Fund Institutional Forum; Dow Jones Private Equity Analyst Limited Partners Summit; Endowments & Foundations Roundtable, Association of Life Insurance Counsel; National Association of Public Pension Fund Attorneys (NAPPA) Hedge Fund Conference; West Legalworks; Annual Euromoney Summit of European Hedge Funds; the Capital Roundtable New York Conference: Fundless Equity Sponsors — How to Raise a Dedicated Private Equity or Mezzanine Fund; the American College of Investment Counsel; the On Point Investor & Hedge Fund Risk Summit; the New Frontiers in Hedge Fund Due Diligence Conference; and the Wharton Private Equity and Venture Capital Conference.

Mr. Wider is listed in *The US Legal 500*, *Chambers Global: The World's Leading Lawyers*, and *Chambers USA: America's Leading Lawyers for Business*. He was named by *Chambers* as one of the leading hedge fund lawyers in the United States and in the world.

Mr. Wider is an editor of the *Morgan Lewis Hedge Fund Deskbook: Legal and Practical Guide for a New Era*, published by Thomson Reuters/West, and has published numerous articles, including:

- "A New Paradigm for Hedge Fund, Captive Fund, and Managed Account Terms and Conditions: A Step Toward Greater Alignment," *Journal of Taxation and Regulation of Financial Institutions*
- "The Tipping Point: The Hedge Fund Investor's Struggle for Legal Balance," *The Investment Lawyer*

- "The Investment Advisers Act: The Need For Clarity In The Post-Goldstein Era," *The Journal of Investment Compliance*
- "In the Twilight of Liberalization," *Private Equity Manager*
- "Shifting the Hedge Fund Balance: Institutional Investor Issues and Concerns," *Bloomberg Law Reports*
- "Enhancing a Mature Investment Program: Customizing the Captive Hedge Fund," *The Journal of Investment Compliance*
- "Read This Before You Spin Out," *Private Equity Manager*
- "Hedge Funds: In the Wake of the SEC Staff Report," *The Journal of Investment Compliance*
- "Hedge Funds: The Regulatory Landscape at a Crossroads," *The Journal of Investment Compliance*
- "Formation and Operation of a Hedge Fund in Today's Market," *European Single Financial Market*

Mr. Wider is an editorial board member of *The Journal of Investment Compliance.* He served as a law clerk to Judge Nicholas H. Politan of the U.S. District Court for the District of New Jersey and to U.S. Attorney Rudolph W. Giuliani of the Southern District of New York.

Mr. Wider received his J.D., cum laude, from Tulane Law School in 1992 and was named to the Order of the Coif and admitted to the National Order of Barristers. He received his A.B. from the Woodrow Wilson School of Public and International Affairs at Princeton University in 1989. He speaks English and French.

Mr. Wider is admitted to practice in New York.

practice accolades

Private Investment Funds

Ranked "#1 Most Active Law Firm" globally, based on the number of funds worked on for limited partners, by *Dow Jones Private Equity Analyst* (2013)

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

honors + affiliations

Listed, *Chambers USA: America's Leading Lawyers for Business* (2006–2012)

Listed, *Chambers Global: The World's Leading Lawyers* (2011–2012)

Listed, Investment Fund Formation and Management: Alternative/Hedge Funds in *The US Legal 500* (2009–2012)

Listed, "Guide to the World's Leading Investment Funds Lawyers," *International Financial Law Review/Expert Guides* (2008)

Listed, *New York Super Lawyers* (2007–2009, 2011)

Editorial Board Member, *The Journal of Investment Compliance*

Member, Private Investment Funds Forum

Member, Association of the Bar of the City of New York, Committee on Private Investment Funds

Member, American Bar Association

Board Member, New York Advisory Board of Facing History and Ourselves
Member, Order of the Coif

education

Tulane University Law School, 1992, J.D., Cum Laude
Princeton University, 1989, A.B.

Morgan Lewis

practice areas

Business & Finance

Private Investment Funds

Private Equity

Investment Management

Financial Services

Investment Advisers

Broker-Dealers

Securities Industry

Broker-Dealer & Capital Markets Regulation

Global Financial Services & Compliance

bar admissions

England & Wales (Solicitor)

William Yonge

partner

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William Yonge is a partner in Morgan Lewis's Business and Finance Practice and a member of the Private Investment Funds Practice. William focuses his practice on providing UK and European financial services regulatory advice to private equity and hedge funds, asset managers, broker dealers, banks, insurers, corporate financiers, securities houses, and financial institutions in addition to regulatory authorities and market associations.

William has represented a broad range of UK and international private equity and hedge funds and other types of clients on financial services law matters, including issues that arise in the course of fund formations, M&A transactions, or the establishment of asset management businesses in the UK. He also advises a number of significant hedge fund sponsors on the structuring, establishment, and marketing of their funds, including offshore hedge funds, and funds of hedge funds, as well as on the legal issues concerned with ISDAs and prime brokerage. William also advises investors on the legal terms of their investments in hedge funds and funds of hedge funds. He has also advised insurance sector clients in relation to their regulatory needs.

William is a frequent speaker at private equity and hedge fund conferences and events. He has also authored a number of articles in publications including the *Journal of Investment Compliance*, *Alternative Intelligence Quotient*, *EuroWatch*, *The Hedge Fund Journal*, and *Lexology*.

Prior to joining Morgan Lewis, William was a partner in the private investment funds practice of an international law firm, resident in its London office. Before entering private practice, he was an in-house lawyer at the Investment Management Regulatory Organisation and the Securities and Investments Board.

William received his B.A. in law from the University of Durham, England.

William is admitted to practice in England and Wales as a Solicitor and is a member of the Chartered Institute for Securities and Investment.

practice accolades

Private Investment Funds

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

Investment Management

Ranked, Band 1: Investment Fund Formation and Management: Mutual Funds in *The U.S. Legal 500* (2012)

Ranked, National Tier 1: Securities/Capital Markets Law, *U.S. News* and *Best Lawyers* (2012)

Ranked, Band 2: Financial Services Regulation: Broker-Dealer Regulation in *Chambers USA* (2012)

Ranked, Band 2: Investment Funds: Registered Funds in *Chambers USA* (2012)

honors + affiliations

Member, Chartered Institute for Securities and Investment

education

University of Durham, England, B.A. (Law)

Morgan Lewis

Richard S. Zarin

partner

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Richard S. Zarin is a partner in Morgan Lewis's Tax Practice resident in the New York office. Mr. Zarin provides counseling on tax matters involving international and domestic transactions, including mergers and acquisitions, the formation and operation of joint ventures, debt and equity restructurings, and securities offerings. His clients, for whom he provides counseling with respect to both transactions and ongoing planning, include companies in the media, financial services, aviation and shipping industries, and the education sector. Mr. Zarin also represents organizers of and investors in onshore and offshore investment funds and other alternative investment vehicles with a broad range of investment objectives, including private equity, venture capital, and hedge funds.

Mr. Zarin served as a judicial law clerk for Judge Max Rosenn, U.S. Court of Appeals for the Third Circuit, in 1985–86.

Mr. Zarin is admitted to practice in New York.

practice areas

Tax
Business & Finance
Transactional Tax Advice
International Tax Practice
Real Estate Funds
Private Equity
Media & Information
Tax Consulting to U.S. Multinationals
Private Equity M&A
Private Investment Funds
Financial Services

bar admissions

New York

practice accolades

Private Investment Funds

Ranked, National Tier 1: Private Funds/Hedge Funds Law, *U.S. News* and *Best Lawyers* (2012)

honors + affiliations

International Law Office (ILO) Client Choice Award Winner (2011)

education

Columbia University Law School, 1985, J.D.

Amherst College, 1981, B.A., Magna Cum Laude

APOLLO
INVESTMENT CORPORATION

Joseph D. Glatt
General Counsel, Apollo Capital Management, L.P.
Secretary and Vice President, Apollo Investment Corporation

Mr. Glatt joined Apollo in 2007 and serves as General Counsel for Apollo Capital Markets. Prior to that time, Mr. Glatt was associated with the law firms of Simpson Thacher & Bartlett LLP from 1998 to 2003 and Schulte Roth & Zabel LLP from 2003 to 2007, in each case, primarily focusing on mergers and acquisitions, leveraged buyouts and capital markets activities. Mr. Glatt serves on the Board of Trustees for FamilyConnections, a community based counseling and family service agency. Mr. Glatt received his JD from University of Pennsylvania Law School and graduated summa cum laude from Rutgers College with a BA in Political Science, Psychology and Hebraic Studies.

Robert Feinstein
Chief Legal Officer, South Carolina Retirement System Investment Commission

Robert Feinstein has worked in the public pension fund field since 1995. He presently serves as Chief Legal Officer for the South Carolina Retirement System Investment Commission. He was legal counsel to the Maryland Retirement System from 1995 to 2005, and served as that fund's Deputy Chief Investment Officer from 2005 to early 2011. Mr. Feinstein has a B.A. from Columbia University, an M.A. from Johns Hopkins University and a J.D. from Yale Law School.

Morgan Lewis