Lowenstein Sandler

Client Alert

Investment Management

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SEC Settlement Reflects Continued Scrutiny Regarding MNPI, Advertisements and Investor Communications

By Scott H. Moss and Jeremy Cantor

On December 26, 2023, the U.S. Securities and Exchange Commission (SEC) announced a settlement with a registered investment adviser, OEP Capital Advisors, L.P. (OEP). The settlement found that OEP had failed (a) to maintain and enforce written policies and procedures reasonably designed to prevent the misuse of potentially material, nonpublic information (MNPI) and (b) to implement written policies and procedures reasonably designed to prevent potentially misleading communications to current and prospective investors in the privately offered private-equity funds that OEP advises.[1]

Background

OEP's Compliance Policies and Procedures Related to MNPI

OEP's compliance manual[2] included policies and procedures relevant to the treatment of MNPI[3] by OEP personnel, including OEP senior personnel. One requirement of OEP's MNPI policy was that MNPI not be disclosed except "as may be necessary for legitimate business purposes."

OEP's Disclosure of MNPI

During the period examined, OEP personnel entered into nondisclosure agreements (NDAs) with various counterparties (including prospective investors). Existing investors were already subject to certain confidentiality restrictions. OEP personnel would then share certain MNPI and other information with such prospective or current investors or other counterparties via, for example, email distributions and other communications. Furthermore, this information was shared with guests (who signed NDAs) who would attend internal investment-update meetings. However, the SEC found that often there was no determination made by OEP that such disclosure was "necessary for legitimate business purposes" as was a requirement under OEP's compliance manual.

Other Relevant Compliance Policies and Procedures

OEP's compliance manual also required that advertisements be subject to compliance approval prior to distribution, include explanatory footnotes regarding performance data, and set forth certain requirements regarding the valuation of securities in investor communications, including that OEP personnel were prohibited from using valuations other than those approved by OEP's valuation committee.

OEP Senior Personnel's Unreviewed Advertisements and Claims Based on Unapproved Valuations

During the period examined, the SEC found that OEP personnel sent emails that included performance-related content to various parties (including to prospective investors) without prior compliance approval or any explanatory footnotes (as was required by OEP's compliance manual). Furthermore, the SEC found that many of these emails were potentially misleading with respect to the valuation of certain portfolio companies and the returns of the relevant fund(s).

OEP's Failure to Implement and Enforce Its Compliance Policies and Procedures

In light of the above, OEP was found to have failed to maintain and enforce its MNPI policies and procedures because "[a]lthough OEP chose to use NDAs as a routine part of its business operations, OEP personnel did not always make an appropriate determination that the prospective disclosure of MNPI, under the circumstances presented, was 'necessary for legitimate business purposes,' as required by OEP's existing written policies and procedures." It should be noted that the SEC specifically took issue with the actual implementation of OEP's MNPI policies and procedures, rather than taking issue with their adequacy or finding any improper trading.

Furthermore, as described above, the SEC found that "OEP also failed to implement its written policies and procedures designed to prevent potentially misleading valuation-based performance claims in investor communications as well as other potentially misleading performance claims in email content sent to more than one person."

<u>OEP's Remedial Efforts/Results</u>

The SEC acknowledged OEP's remedial efforts, which included, among other things, (a) improving OEP's MNPI-related policies and procedures, (b) personnel training regarding investor communications, and (c) OEP's cooperation with the SEC. Nevertheless, the SEC ultimately fined OEP $4 million for the foregoing actions.

Other Cases

The OEP case is not the first example of the SEC taking issue with MNPI-related policies and procedures. For example:

- In 2017, an investment adviser was fined (and had to disgorge profits) related to trades made by the adviser that violated its compliance policies and procedures related to MNPI (but the SEC did *not* allege any improper trading); and
- In two different 2020 settlements, two investment advisers were fined for (a) having inadequate policies and procedures related to the handling of MNPI and (b) a failure to properly comply with their own MNPI policies and procedures (but the SEC did *not* allege any improper trading).

Takeaways

This settlement is an important (and not unforeseeable) reminder that the SEC continues to focus on investment advisers (and the funds they advise) with respect to MNPI[4] and advertisements/investor communications and the policies and procedures governing the treatment thereof. Further, this settlement indicates a growing trend of the SEC being more willing to accept no admission of findings when bringing enforcement actions. We believe this trend will continue.

However, there are a few items from the settlement that we found especially noteworthy. First, the settlement ($4 million) appears steep for the conduct alleged (as there was no mention of improper trading with respect to MNPI or investor harm), and recipients of MNPI were subject to contractual confidentiality restrictions in NDAs or otherwise. Similarly, in reviewing the settlement amounts from the cases referenced above (which mainly focused on violations of MNPI-related policies and procedures), we believe the amount was steeper here due to the advertisements/investor communication-related violations referenced in the settlement. Second, the settlement does not mention a violation of the Marketing Rule[5] (notwithstanding that it involved investor and prospective investor communications, some of which may have been considered "advertisements" thereunder). Last, it raises the concept of balancing compliance policies and procedures with practicality. More specifically, under OEP's compliance manual, OEP personnel were only permitted to disclose MNPI "as may be necessary for legitimate business purposes." The SEC found that oftentimes determinations were not made that disclosure was "necessary for legitimate business purposes." This begs the questions of when this determination must have been made and how such determination should have been properly memorialized (or thought about).

Consequently, advisers should carefully examine their policies and procedures regarding MNPI and advertisements/investor communications and should also review their business activities to help ensure that such activities comply with the adviser's compliance policies and procedures (and, conversely, that the adviser's policies and procedures are both compliant with relevant laws and properly tailored to the adviser's business).

As it is the beginning of a new year, it is a good time to incorporate these concepts into compliance trainings and reminders. Therefore, advisers should also ensure that their personnel are properly trained and fully understand the adviser's compliance

policies and procedures, including, but not limited to, those related to advertisements/MNPI and investor communications. In that vein, advisers should be mindful of (a) how MNPI might be shared (whether intentionally or inadvertently) and (b) what adviser personnel would be in a position to share MNPI or otherwise distribute advertisements/investor communications so that the adviser can further tailor its policies and procedures.

However, this is not a "one-and-done" approach. Advisers should continuously monitor these programs and constantly strive to improve them. As new funds launch and as operations, personnel, and business strategies, among other things, continue to change, advisers should conduct ongoing compliance reviews and trainings and continuously update disclosures, policies, and procedures as appropriate.

Next Steps

For further information, guidance, and clarity on how advisers can approach and tailor their policies and procedures related to MNPI and advertisements/investor communications (including, but not limited to, personnel training) and/or factor the foregoing into their annual compliance review and periodic risk/conflict assessment, please reach out to the authors, Scott Moss, Co-Chair of Lowenstein Sandler's Investment Management Group and Chair of the firm's Fund Regulatory & Compliance Group, and Jeremy Cantor, associate in the firm's Investment Management Group; or reach out directly to your regular Lowenstein Sandler contact.

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[1] https://www.sec.gov/files/litigation/admin/2023/ia-6514.pdf.
[2] Pursuant to 17 CFR § 275.206(4)-7(a), registered investment advisers are required to adopt and implement written policies and procedures reasonably designed to prevent violation, by the advisers and its supervised persons, of the Investment Advisers Act.
[3] Section 204A of the Investment Advisers Act requires investment advisers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of MNPI by the adviser or any of its associated persons.
[4] *See, e.g.*, https://www.sec.gov/files/Private Fund Risk Alert_0.pdf and https://www.sec.gov/files/code-ethics-risk-alert.pdf.
[5] 17 CFR § 275.206(4)-1.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

SCOTT H. MOSS
Partner
Chair, Fund Regulatory & Compliance
Co-chair, Investment Management Group
T: 646.414.6874
smoss@lowenstein.com

JEREMY CANTOR
Associate
T: 212.419.5986
jcantor@lowenstein.com

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