

Not All the News Is Fit to Print

By: Mark Shayne, Senior Managing Director

I recently read Prof. Jeffrey Edward Green's *Bob Dylan: Prophet Without G-d*. So, the song "Rainy Day Women #12 and 35" (colloquially known as, "Everybody Must Get Stoned") was on my mind when I was reviewing the latest SEC proceeding punishing a hedge fund (September 30, 2024). The fund agreed to a \$1.5mm penalty for insufficient controls over material non-public information ("MNPI").

The SEC lays out the scenario:

The fund (a well-respected fund with AUM of \$25B) had written policies and procedures in place that provided general guidance for evaluating and handling potential MNPI. However, these policies and procedures were not designed to address the risks specifically related to the potential for receipt and misuse of MNPI resulting from participation on ad hoc creditors' committees.

The fund's MNPI procedures listed several examples where an employee would be deemed in possession of MNPI, including where the "employee [is] serving on a creditors' committee of a restructuring." However, according to the SEC, "the fund did not establish, maintain, or enforce policies and procedures for monitoring or supervision specifically addressing the risk of receiving or misusing MNPI during participation in an ad hoc creditors' committee" [italics mine].



The SEC found that the fund failed to establish and adopt policies and procedures reasonably designed to address the risk related to the potential for inadvertent receipt of MNPI resulting from participation on ad hoc creditors' committees, **including interactions with financial advisers or other consultants for the ad hoc creditors' committee** (emphasis mine). Specifically, there were no policies or procedures for employees to conduct due diligence concerning advisers' evaluation or handling of potential MNPI or for obtaining a representation from advisers concerning their policies and procedures for handling of MNPI.

Did I mention that no trading occurred? Nevertheless, the SEC found that the fund violated Sections 204A and 206(4) of the Advisers Act and Rule 206(4) -7.

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What's Bothering the SEC?

Was the SEC upset that the fund's MNPI policies addressed creditor committees, but not ad hoc creditor committees? Maybe, but I think the issue was that the fund worked with a foreign financial adviser throughout the restructuring process, and the fund did not receive any written representations from the adviser about the latter's handling of MNPI, nor did the fund perform due diligence on the adviser's handling of MNPI.

Note that the adviser had entered into an NDA with the company subject to restructuring. Should that have been enough diligence for the fund? We report; you decide. The SEC, however, felt not.

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