

SIDLEY UPDATE

FY2024 in Review: SEC Enforcement Actions Against Investment Advisers to Private Funds, Registered Funds, and Retail Clients

November 12, 2024

In its 2024 fiscal year that ended on September 30, the U.S. Securities and Exchange Commission (SEC or Commission) brought over 130 enforcement actions against investment advisers and their representatives. Here, we provide an overview of key areas of focus and notable actions addressing the following topics:

- I. Specific rule enforcement, including
 - a. sweeps related to the marketing rule, recordkeeping (off-channel communications), and beneficial ownership reporting
 - b. whistleblower protection rules
 - c. custody rule
 - d. pay-to-play rule
- II. Conflicts of interest-related practices and disclosures, including
 - a. fees, expenses, and other undisclosed compensation
 - b. revenue sharing
 - c. valuation
 - d. trade allocation
- III. Misrepresentations, omissions, and inadequate disclosures
- IV. Hedge clauses
- V. Artificial intelligence
- VI. Material non-public information
- VII. Litigated actions, including related to “shadow trading,” valuation, expense reimbursement, revenue sharing, and custody rule
- VIII. Compliance failures

Rule Enforcement

Recent and Ongoing Sweeps

The SEC has been actively using market-wide “sweeps” as a way to efficiently investigate similar conduct by multiple investment advisers and to send a stronger message to the market. During the 2024 fiscal year, the SEC brought charges against over 60 investment advisers through enforcement sweeps and other investigations of similar violations.

- *Marketing Rule.* In September, the SEC charged nine registered investment advisers in an ongoing sweep for violating the Marketing Rule by disseminating advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures.¹ Without admitting or denying the allegations, the firms’ settlements included a total of \$1,240,000 in penalties that ranged from \$60,000 to \$325,000, in addition to undertakings.

Earlier in the year, in April, the SEC similarly charged five registered investment advisers with Marketing Rule violations, including advertising hypothetical performance on the adviser’s website without having policies and procedures in place reasonably designed to ensure that hypothetical performance was relevant to the likely financial situation and investment objectives of each member of the advertisement’s intended audience. The advisers agreed to pay \$200,000 in combined penalties, which ranged individually from \$20,000 to \$100,000, after the SEC credited certain advisers for pre-investigation corrective action, and to comply with undertakings.² The SEC brought a similar standalone case in August in which the adviser agreed to pay a \$430,000 civil penalty and comply with undertakings.³

In another standalone enforcement action in June, the SEC charged a private fund adviser with disseminating misleading performance advertising to prospective investors by advertising returns experienced by a single investor without disclosing that the returns did not constitute overall fund performance but rather a representative investor’s account, which, at times, substantially differed from the overall performance of the fund.⁴ The adviser agreed to pay \$100,000 to settle the charges, with the SEC’s order noting its remedial efforts.

- *Off-Channel Communication Recordkeeping.* The SEC has continued to charge investment advisers and other registrants for recordkeeping failures. In 2024, the SEC charged 22 broker-dealers, 20 dually-registered broker-dealers and investment advisers, nine affiliated investment advisers, and five standalone investment advisers for failures to maintain and preserve off-channel communications on personal devices.⁵ The adviser entities were ordered to pay approximately \$528.4 million of approximately \$568.7 million in combined penalties, with individual penalties of up to \$50 million. All but one firm admitted to the facts set forth in their respective SEC orders, and the vast majority agreed to undertakings, including the retention of an independent compliance consultant.

The 2024 year also included the first of several standalone actions against investment advisers for recordkeeping violations, despite the lack of clarity on the SEC’s interpretation of the scope of electronic communications subject to the Advisers Act recordkeeping rule.⁶ Also of note, on the eve of its fiscal year end, the SEC brought its first two settled actions against investment advisers without any monetary sanctions. In the first action, the SEC’s order noted the adviser’s self-reporting, remedial efforts, and cooperation, including its “cooperation in the Commission staff’s investigation of another entity,” and did

¹ Link [here](#).

² Link [here](#). While four of the five advisers received reduced penalties due to corrective actions, the SEC’s order noted remedial acts taken by the fifth adviser, as well.

³ Link [here](#). Here, too, the SEC noted that it considered the adviser’s cooperation in determining to accept the settlement.

⁴ Link [here](#).

⁵ Links [here](#), [here](#), [here](#), [here](#), and [here](#). In September 2024, the Commission also brought its first charges against 12 standalone municipal advisers for similar recordkeeping failures, with the firms collectively paying more than \$1.3 million in civil penalties to settle the actions. Link [here](#).

⁶ Link [here](#). For additional information, see the following Sidley alert: [SEC Files First Charges Against Standalone Investment Adviser for Off-Channel Communication Recordkeeping Failures](#).

not require an admission of liability.⁷ In the second action, the SEC again noted the adviser's self-reporting, remedial efforts, and cooperation, as well as its self-policing of existing policies and procedures going back to 2012. The SEC also found that the adviser had implemented and enforced a compliant text-messaging process in early 2017 that enabled the firm to retain business communications via text, which process the adviser enhanced over time.⁸

- *Beneficial Ownership Reporting.* On September 17, the SEC charged 11 institutional investment managers for failing to file reports on Form 13F, which they were required to file because they have discretion over more than \$100 million in certain securities.⁹ Two firms were also charged with failing to file Forms 13H as required for large traders who trade a significant amount of exchange-listed securities. Nine of the firms agreed to collectively pay more than \$3.4 million in penalties to settle the matters, with fines ranging from \$175,000 to \$725,000. Emphasizing the benefits of self-reporting and cooperation, two of the firms paid no financial penalties.

On September 25, the SEC charged another 13 entities, of which five were investment advisers, and 10 individuals for reporting failures related to Schedules 13D and 13G reports and Forms 3, 4 and 5.¹⁰ Schedules 13D and 13G provide information about the holdings and intentions of investors who beneficially own more than 5% of any registered voting class of public company stock; Forms 3, 4, and 5 are reports used to provide information about public company stock transactions by corporate officers, directors, or certain investors who beneficially own more than 10% of the stock. The SEC also charged two public companies for contributing to the filing failures of their officers and directors and failing to report those filing delinquencies. Collective penalties exceeded \$3.8 million, with the adviser firms paying penalties ranging from \$75,000 to \$375,000.

Whistleblowers Protection Rules

Demonstrating its ongoing focus on upholding whistleblower protection under Exchange Act Rule 21F-17, the SEC charged advisers who impeded potential whistleblowers from reporting securities laws violations to the Commission. The SEC is conducting an ongoing investigative sweep concerning private fund advisers' compliance with this Rule.

- The SEC charged a dually-registered investment adviser and broker-dealer with impeding advisory clients and brokerage customers from reporting potential securities laws violations to the SEC by regularly requiring clients to sign confidential release agreements if they had been issued a credit or settlement from the firm of more than \$1,000.¹¹ The agreements required the clients to keep confidential the settlement, all underlying facts relating to the settlement, and all information relating to the account at issue. While agreements permitted clients to respond to SEC inquiries, they did not permit clients to voluntarily contact the SEC. The firm agreed to a \$18 million penalty to settle the charges, with the SEC noting the firm's remedial acts.
- In a settled action, the SEC charged three affiliated registrants, including a Commission-registered investment adviser and a state-registered investment adviser, for impeding brokerage customers and advisory clients from reporting securities law violations to the SEC by asking retail clients to sign confidentiality agreements in connection with payments made by the entities to the clients' investment accounts, which permitted communications with the SEC only where the SEC initiated an inquiry.¹² Certain agreements also required the clients to represent that they had not reported the underlying dispute to the SEC or to another securities regulator and would forever refrain from such reporting. The respondents agreed to a \$240,000 penalty to settle the matter, with the SEC's order noting the respondents' remedial efforts and cooperation.

⁷ Link [here](#).

⁸ Link [here](#). See also Commissioners Hester Pierce, Mark Uyeda [statement](#).

⁹ Link [here](#).

¹⁰ Link [here](#).

¹¹ Link [here](#).

¹² Link [here](#).

- The SEC charged an investment adviser for entering into nondisclosure agreements with candidates for employment that prohibited them from disclosing confidential information about it, including to government agencies. While the agreements permitted candidates to respond to Commission requests, they required notification to the adviser and prohibited responding to requests without consultation with the adviser.¹³ The SEC's order also found that the adviser entered into a settlement agreement with a former employee that required the employee to affirm that he or she had not reported possible securities violations to the Commission, was not aware of facts that would support an investigation, and would withdraw any statements already made that might support an investigation. To settle the charges, the SEC's order imposed a \$500,000 penalty and noted the adviser's cooperation and remedial efforts.

Custody Rule

During the 2024 fiscal year, the SEC has continued to bring several actions against investment advisers alleging failures to comply with requirements related to safekeeping client assets in violation of the custody rule.

- The SEC charged an adviser to a private fund that primarily invested in digital assets with failing to maintain certain assets with a qualified custodian because the adviser maintained certain digital assets in online trading accounts on digital asset trading platforms, including FTX Trading Ltd., which did not satisfy the definition of qualified custodians.¹⁴ The adviser agreed to a \$225,000 civil penalty to settle the charges.
- The SEC charged an investment adviser that provided advisory services to pooled investment vehicle clients concerning real estate investments and had custody of the assets of those clients with failing to have the fund and securities of certain of the pooled investment vehicles verified by actual examination or audited.¹⁵ The SEC also alleged related policies and procedures violations. To settle the charges, the adviser agreed to pay a \$300,000 civil penalty.
- In a settled action, the SEC charged an adviser to two private real estate operating company funds with violating the custody rule by failing to comply with the surprise examination requirement for certain years and by failing to adopt and implement written policies and procedures reasonably designed to prevent custody rule violations.¹⁶ The adviser agreed to a \$50,000 penalty and to hire an independent compliance consultant.

Pay-to-Play Rule

In the lead-up to the 2024 election, the SEC brought charges against advisers for violating the "pay-to-play" rule, which addresses abuses involving campaign contributions made by investment advisers or their associates to government officials who are in a position to influence the selection of investment advisers to manage government client assets, such as the assets of public pension funds.

- The SEC charged an investment adviser that provided advisory services to a state fund after an employee made a campaign contribution to a government official whose office had influence over the selection of the fund's investment adviser with violating the Commission's pay-to-play rules.¹⁷ While the employee made the contribution before he was hired by the adviser, the Commission's pay-to-play rules required a "time out" on the adviser providing services to the state fund, beginning at the time of the employee's hire and ending two years after his contribution. The order also noted that the investment adviser did not qualify for an exemption from the rule despite the fact that the employee sought and attained the return of his contribution because (1) the contribution exceeded the exemption maximum, and (2) the return was not timely. The adviser agreed to pay a civil penalty of \$95,000 to settle the charges.

¹³ Link [here](#).

¹⁴ Link [here](#). For additional information, see the following Sidley alert: [Crypto-Focused Private Fund Adviser Settles with U.S. SEC for Custody Rule and Other Violations](#).

¹⁵ Link [here](#).

¹⁶ Link [here](#).

¹⁷ Link [here](#). See also Commissioner Hester Pierce [statement of dissent](#).

- The SEC charged an investment adviser with violating the Commission's pay-to-play rules after an employee contributed to the campaign of a government official who sat on a state investment board that had invested funds with the adviser since 2007.¹⁸ The adviser agreed to pay a \$60,000 civil penalty to settle the charges resulting from its failure to enact a two-year time out, effective the date of the employees' contribution.

Conflicts of Interest

Fees, Expenses, and Other Undisclosed Compensation

The SEC continues to bring enforcement actions against advisers concerning conflicts of interest arising from fees, expenses, and other undisclosed compensation.

- In a settled action, the SEC charged a mutual fund adviser for entering into an impermissible joint legal fee arrangement with its client, a registered open-end investment company.¹⁹ The SEC alleged that the adviser improperly arranged for its client to pay legal fees and expenses associated with regulatory inquiries and private litigation following significant fund losses, which resulted in the mutual fund temporarily paying a disproportionately high amount of fees. The adviser agreed to pay approximately \$511,000 in combined monetary sanctions to settle the matter.
- The SEC charged an adviser with failing to fully and fairly disclose material facts and conflicts of interest relating to its agreements with an investment manager for certain exchange traded funds (ETF Manager).²⁰ The SEC's order alleged that the adviser failed to disclose conflicts of interest arising from agreements it had entered into with the ETF Manager whereby the adviser would be paid certain fees that created an incentive for the adviser to use the funds managed by the ETF Manager. The order also found that the adviser failed to implement written compliance policies and procedures related to the disclosure of conflicts of interest. To settle the charges, the adviser agreed to a \$125,000 civil penalty and approximately \$160,000 in disgorgement and prejudgment interest and to comply with undertakings.
- The SEC charged a private fund adviser with breaches of its fiduciary duty related to its failure to follow certain contractually agreed procedures governing the timely disclosure of, and consent to, expenses that it allocated to private real estate investment funds it managed, as well as compliance failures.²¹ The SEC's order noted the adviser's cooperation and remedial efforts, and the adviser agreed to a \$350,000 civil penalty to settle the charges.
- The SEC charged a dually-registered broker-dealer and investment adviser for failing to disclose to its advisory clients a conflict of interest created by incentive fees that it received from the clearing firm that it recommended to its clients for clearing, execution, and custodial services and for related compliance violations.²² To settle the charges, the firm agreed to pay a \$175,000 penalty, with the SEC's order noting the adviser's cooperation and remedial efforts.
- In the 2024 fiscal year, the SEC pursued actions against dually-registered broker-dealers and investment advisers for violations of Regulation Best Interest (Reg BI) where those violations overlapped with other duties advisers owe to their clients. Reg BI establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities. For example, the SEC charged a dually-registered broker-dealer and investment adviser for its alleged failure to comply with Reg BI by recommending that certain of its brokerage customers and advisory clients transfer securities to new investment accounts with its affiliated wealth management firm, without disclosing that the representatives would receive compensation for making the recommendations and for any securities transfers, which the SEC found to be a conflict of interest.²³ The SEC's order also found that the adviser's written policies and procedures

¹⁸ Link [here](#). See also Commissioner Pierce [statement of dissent](#).

¹⁹ Link [here](#).

²⁰ Link [here](#).

²¹ Link [here](#).

²² Link [here](#).

²³ Link [here](#).

were not reasonably designed to achieve compliance with disclosure obligations under Reg BI and the Advisers Act with regard to conflicts of interest associated with the recommendations to transfer securities. The adviser agreed to pay a \$223,228 civil penalty to settle the charges.

- In a settled action, the SEC charged an adviser for breaches of its fiduciary duty relating to false and misleading disclosures relating to its receipt of certain compensation from an independent third-party adviser that agreed to provide investment models for its use and to pay it a fee based on the amount of funds invested in that adviser's model portfolios.²⁴ The SEC's order also found that the adviser made misleading disclosures about its portfolio management fees in addition to compliance failures and recordkeeping violations. The adviser agreed to pay over \$250,000 in total monetary penalties and comply with undertakings, with the SEC's order noting the adviser's cooperation and remedial efforts.

Revenue Sharing

Continuing a several years-old trend, the SEC brought several actions against advisers related to disclosures and practices concerning revenue sharing and other alleged financial conflicts of interest.

- The SEC charged a dually-registered broker-dealer and investment adviser for breaches of fiduciary duty related to its receipt of third-party revenue without fully and fairly disclosing its conflicts of interest.²⁵ Specifically, the SEC's order alleged that the firm failed to provide full and fair disclosure regarding its receipt of (1) revenue sharing payments from its unaffiliated clearing broker as a result of advisory clients' investments in certain no-transaction fee mutual fund share classes, (2) revenue sharing payments from its clearing broker as a result of sweeping cash into certain money market mutual funds, and (3) markups on the clearing broker's fees for certain advisory clients' transaction fees. The SEC's order also alleged that the firm breached its duty to seek best execution and its duty of care in connection with its recommendation and selection of cash sweep account options and no-transaction fee mutual fund share classes for clients. Finally, the SEC found that the firm failed to adopt and implement related compliance policies and procedures. The firm agreed to pay a civil penalty of \$1 million and over \$5 million in disgorgement and prejudgment interest and to comply with certain undertakings.
- The SEC charged a private fund adviser and its founder with breaching their fiduciary duties by failing to disclose conflicts of interest regarding an undisclosed fee the founder received for investing clients' money in films.²⁶ The SEC also alleged that the respondents misrepresented to clients that the founder earned such compensation for work as an executive producer on the films, among other things. To settle the charges, the adviser agreed to pay a civil penalty of \$200,000, and the founder agreed to pay more than \$600,000 in disgorgement and prejudgment interest as well as a \$150,000 civil penalty.
- In a settled action, the SEC charged a private fund adviser for failing to properly disclose and gain consent for certain client short-term loan transactions involving conflicts of interest.²⁷ The SEC also charged the adviser with violating the custody rule for failing to deliver required audited financial statements to private fund investors in a timely manner, as well as compliance violations. The adviser agreed to pay a \$250,000 penalty to settle the charges.

Valuation

The SEC continues to charge advisers in connection with valuation-related violations and for related compliance failures. For example, in September, the SEC charged a private fund adviser for overvaluing approximately 4,900 largely illiquid collateralized mortgage obligations (CMOs) held in 20 advisory accounts, including 11 retail mutual funds.²⁸ The SEC's order alleged that the adviser managed a fixed-income investment strategy primarily invested in mortgage-backed securities, CMOs, and treasury futures, including "odd lot" CMO positions that traded at a discount, and used a third-party pricing service that did not provide separate evaluations for the odd lots, which were then marked at inflated prices. The SEC's order also found the adviser attempted to minimize losses to

²⁴ Link [here](#).

²⁵ Link [here](#).

²⁶ Link [here](#).

²⁷ Link [here](#).

²⁸ Link [here](#).

redeeming investors by arranging cross trades with affiliated accounts rather than selling the overvalued CMOs into the market, which resulted in the retail mutual funds absorbing losses that otherwise would have been borne by the selling account in a market sale. Finally, the SEC found related false and misleading disclosures and compliance deficiencies. To settle the charges, the adviser agreed to pay a \$70 million civil penalty and approximately \$10 million in disgorgement and prejudgment interest and agreed to comply with undertakings, including by continuing its retention of an independent compliance consultant.

Trade Allocation

The SEC also continues to bring actions for “cherry picking,” a practice of fraudulently allocating profitable trades to favored accounts at the expense of other advisory clients. In one action this fiscal year, for example, the SEC issued a settled order charging a registered adviser and its predecessor entity in connection with a multi-year cherry-picking scheme of two representatives previously associated with the entities.²⁹ The SEC’s order found that the firms failed reasonably to supervise the two investment adviser representatives and failed to design and implement policies and procedures reasonably designed to prevent unfair trade allocations, among other charges. To settle the charges, each entity agreed to a \$200,000 penalty, with the SEC’s order citing the adviser’s cooperation and remedial acts. On the same day, the SEC also filed complaints against the two registered representatives alleging they defrauded their clients through the cherry-picking scheme, which litigations are ongoing.³⁰

Misrepresentations, Omissions, and Inadequate Disclosures

In addition to undisclosed conflicts, the SEC remains focused on other types of material misstatements and omissions to clients and investors, as well as other inadequate disclosures. These matters involved inaccuracies in periodic reports filed with the SEC, disclosure failures related to a social media influencer’s role and compensation in a product launch, account performance, financial incentives related to insurance product sales for advisory clients, calculation discrepancies, and short publisher reports.

- *Preferential Redemption Practices.* In a settled action, the SEC found that a registered investment adviser to private funds misled certain investors about its redemption practices for a fund, among other findings. The fund’s limited partnership agreement required 30 days’ notice for fund investors to redeem unless the general partner approved a shorter notice period. The adviser allowed certain fund investors to redeem with less than five business days’ notice. The SEC found misleading the practice of allowing certain investors, including some affiliated investors, to redeem on shorter notice while disclosing a different redemption policy and practice to other investors. To settle the charges, the adviser agreed to pay a penalty of \$225,000.³¹
- *Investment Limits.* The SEC charged a dually-registered broker-dealer and investment adviser with failing to adequately inform clients that a third-party investment adviser, who was also charged, materially exceeded investment exposure levels specifically designated by the clients in a strategy that the third-party adviser managed.³² As a result, certain clients paid higher fees, were subjected to increased market exposure, and incurred investment losses. The firms were also charged with compliance failures. To settle the charges, the dually-registered firm agreed to pay a \$1 million penalty and \$2.8 million in disgorgement and prejudgment interest. The third-party adviser agreed to pay a \$2 million penalty and \$3.5 million in disgorgement and prejudgment interest.
- *Promoter Role.* The SEC charged an adviser with disclosure failures in connection with a social media influencer’s role in the launch of its new exchange-traded fund, including failing to disclose the influencer’s planned involvement and a sliding scale fee structure to incentivize the influencer’s marketing and promotion efforts, and related compliance failures.³³ The adviser agreed to pay a \$1.75 million penalty to settle the charges. The SEC’s order noted the adviser’s remedial efforts.

²⁹ Link [here](#).

³⁰ Links [here](#) and [here](#).

³¹ Link [here](#).

³² Links [here](#) and [here](#).

³³ Link [here](#).

- *Presentation of Investments and Performance History.* In a settled action, the SEC charged a Florida-based adviser not registered with the Commission in any capacity and its owner (an independent investment adviser representative and registered representative associated with a separate registered adviser) with making misleading statements in written communications to prospective and existing advisory clients regarding the presentation of clients' investment or proposed investments and performance history.³⁴ To settle the action, the adviser and its owner agreed to pay civil penalties of \$100,000 and \$50,000, respectively, and to comply with undertakings.
- *Calculation of Investment Returns.* The SEC charged an adviser to a public employees' pension fund and the firm's former partner with misleading the fund about the reason for a discrepancy between two different calculations of its investment returns for the same period.³⁵ To settle the charges, the adviser agreed to approximately \$1.54 million in total monetary penalties, and the former partner agreed to pay a \$30,000 civil penalty. The SEC's order credited the adviser's remedial efforts.
- *Short Publishers.* The SEC charged a private fund adviser and an exempt reporting adviser for making misleading disclosures in connection with their work with activist short publishers.³⁶ The private placement memorandum for the flagship fund that the firms advised described the fund's short position investment strategy but omitted that the strategy involved working with activist short publishers who issued articles presenting bearish views of target securities, trading in the target securities around the time the reports were issued, and paying a portion of the fund's trading profits to the short publishers in exchange for the short publishers sharing their work in advance of publication. The SEC also charged the firms with compliance failures. The firms agreed to pay civil money penalties of \$1.25 million and \$1 million, respectively, to settle the charges.
- *Fee Inaccuracies.* In a settled action, the SEC charged an adviser and its principal for providing information to federal employee clients regarding thrift savings plan (TSP) fees, TSP investment options, and individual retirement account (IRA) money manager fees that was inaccurate or omitted material facts.³⁷ This included telling clients that fees were higher than they were in actuality and continuing to do so after the SEC's Division of Examinations notified the principal of the inaccuracy. The SEC's order also found that the adviser and the principal, who also served as the adviser's chief compliance officer, took no action to adopt and implement written policies and procedures intended to ensure that the adviser adhered to the fiduciary duty that it owed to clients. The adviser also failed to retain, and had no written policies and procedures regarding, text messages sent or received by its representatives to or from clients and prospective clients relating to advice given or proposed to be given, disbursement of funds or securities, or the placing or execution of securities transactions. The adviser and principal agreed to pay penalties of \$200,000 and \$80,000, respectively, as well as comply with undertakings. The principal also agreed not to act in a compliance capacity for a registered investment adviser or other SEC-registered entity.

Hedge Clauses

This year, the SEC also brought charges against advisers relating to hedge clauses.

- The SEC charged an adviser for including misleading liability disclaimers, or "hedge clauses," in various agreements with retail investor and private fund clients in Investment Company Act Section 3(c)(1) funds. By purporting to limit the adviser's liability and fiduciary duty, the SEC found that the disclaimers could mislead a client to believe that it had waived non-waivable causes of action against the adviser under state or federal law.³⁸ The SEC also found custody rule violations for failing to distribute to certain investors timely annual audited financial statements, as well as compliance failures. To settle the matter, the adviser agreed to pay a \$65,000 civil penalty, with the SEC considering its remedial acts in determining to accept the settlement.

³⁴ Link [here](#).

³⁵ Links [here](#) and [here](#).

³⁶ Link [here](#).

³⁷ Link [here](#).

³⁸ Link [here](#).

- The SEC charged an investment adviser in part for including liability disclaimer language in its advisory contracts with clients that purported to relieve the adviser from liability for “any claim or demand” and included broad indemnification provisions, among other findings. Here, too, the SEC found the language created the misleading impression that clients had waived non-waivable causes of action against the adviser.³⁹ In determining to settle the charges for a \$175,000 civil penalty, the SEC noted that the adviser cooperated with the investigation and took remedial steps.

Artificial Intelligence

Underscoring the Commission’s recent focus on artificial intelligence (AI), the SEC brought actions against advisers for AI-related violations, in particular for “AI-washing,” the practice of making false or misleading statements about firms’ purported use of AI.

- The SEC charged a former investment adviser with making false and misleading statements in its regulatory filings, advertisements, and social media relating to its purported use of AI and machine learning, including by representing that it used AI and machine learning to analyze retail clients’ spending and social media data to inform its investment advice when no such data in fact was being used in the investment process.⁴⁰ These statements first came to the SEC’s attention during a 2021 exam. Following the exam, the adviser updated certain statements relating to its use of AI but continued to make the false statements in advertisements concerning its use of client data. The SEC also found compliance failures, including that the adviser lacked policies and procedures (1) relating to social media and (2) laying out a clear advertising review and approval process. Citing the adviser’s cooperation, the SEC settled the charges for a \$225,000 civil penalty.
- In a settled action, the SEC charged an investment adviser with making false and misleading claims about its use of AI, including that it was the “first regulated AI financial advisor” and that it used “[e]xpert AI driven forecasts” when it did not.⁴¹ The SEC’s order, which also included other findings, noted the adviser’s remedial acts and cooperation in accepting a \$175,000 penalty to settle the charges.
- The SEC filed litigated charges against an investment adviser, its holding company, and its CEO for defrauding clients out of at least \$6 million.⁴² The complaint alleges that the adviser and its CEO made false and misleading statements, including falsely claiming that the adviser would provide exceptional returns using AI and promising that clients’ capital was “100% protected,” that the holding company had taken steps to go public, and that the adviser was receiving financial and legal services from well-known and reputable firms. The SEC is seeking an injunction, disgorgement with prejudgment interest, a civil penalty, and an officer and director bar.

Material Non-Public Information

The SEC brought a number of settled actions against private fund advisers for compliance issues relating to the misuse of material non-public information (MNPI), in each case without any allegation or suggestion that the adviser engaged in insider trading. In two of these matters, the SEC Division of Enforcement articulated for the first time expectations concerning MNPI policies and procedures related to participation in ad hoc lender groups or creditors’ committees.

- The SEC charged an investment adviser with failure to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of MNPI concerning its collateralized loan obligations (CLOs). The order found that prior to July 2022, the adviser had no written policies and procedures aimed at preventing the misuse of MNPI about the underlying loans when trading its or third-party CLOs.⁴³ In late July 2019, after weeks of discussing reducing exposure to certain CLOs, a co-portfolio manager at the adviser requested approval to sell certain CLOs that contained loans by one company from the adviser’s compliance department. Approval was granted, despite the fact that

³⁹ Link [here](#).

⁴⁰ Link [here](#).

⁴¹ Link [here](#).

⁴² Link [here](#).

⁴³ Link [here](#).

investment personnel had communicated to compliance personnel certain information regarding the need for rescue financing by that same company. The SEC's order found that, although certain personnel recognized that the firm was in possession of MNPI at the time of the trades, which it had obtained in connection with its participation in an ad hoc lender group, the adviser failed to consider whether such information was also material with respect to these CLO tranches before it sold them. The adviser agreed to a \$1.8 million civil penalty to settle the charges, with the SEC considering its remedial acts and cooperation in determining to accept the settlement offer.

- The SEC charged a private fund adviser for failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of MNPI relating to its participation on ad hoc creditors' committees.⁴⁴ The SEC did not find, or even suggest, that the adviser engaged in insider trading. The firm had policies and procedures in place that provided general guidance for evaluating and handling MNPI. The order faulted the adviser's policies and procedures for not including steps to conduct due diligence on, or obtain representations from, third-party financial advisers to the creditors' committees concerning their evaluation and/or handling of MNPI and for failing to include procedures for monitoring or supervision specifically aimed at such participation. The order credits the adviser for remedial acts, including training and revising its MNPI policies and procedures. The adviser agreed to settle to compliance related charges and pay a penalty of \$1.5 million.
- The SEC charged a private fund adviser with failure to maintain and enforce policies and procedures reasonably designed to prevent the misuse of MNPI and the publication of misleading claims regarding fund performance.⁴⁵ While the adviser's MNPI policies and procedures prohibited disclosure of MNPI when not "necessary for a legitimate business purpose," on "numerous occasions," the adviser provided MNPI to investors who were subject to non-disclosure or confidentiality agreements without considering whether the disclosure was "necessary for a legitimate business purpose." Additionally, the adviser did not observe its policies and procedures regarding communications, publishing communications without approval from compliance and without explanatory footnotes. Citing the adviser's cooperation and remedial efforts, which included promptly enhancing its policies and procedures and compliance training, the SEC agreed to settle the charges with a \$4 million civil penalty.

Litigated Actions

In the 2024 fiscal year, there were also several notable developments in litigated enforcement actions against investment advisers.

- *"Shadow Trading."* In a case with implications for investment advisers, the SEC prevailed in a jury trial against an individual for using confidential information about an impending announcement of an acquisition of his then-employer to trade in the securities of another comparable public company by purchasing short-term, out-of-the-money call options.⁴⁶ This has come to be known as the "shadow trading" theory of liability, where information about one company may be material to another unaffiliated company.
- *Insurance-affiliated investment advisers.* The SEC won a motion to dismiss against an investment adviser affiliated with an insurance company and its principal, in which the principal also was registered as an insurance agent with a separate insurance agency.⁴⁷ The court held that where the principal advised clients concerning asset allocation as between securities and non-securities fixed indexed annuities, the defendants owed clients an investment advisory fiduciary standard of care and an investment advisory standard of disclosure, notwithstanding that the principal complied with insurance-law standards of disclosure and despite statutory provisions forbidding the SEC from regulating insurance. This decision has led to multiple SEC examinations and enforcement investigations against dual-hatted insurance agent/investment adviser firms and their principals.

⁴⁴ Link [here](#).

⁴⁵ Link [here](#).

⁴⁶ Link [here](#). The individual's motion for a new trial was also recently denied. See *SEC v. Panuwat*, No. 21-cv-06322-WHO (N.D. Cal. Sept. 9, 2024).

⁴⁷ Link [here](#).

- *Valuation.* The SEC obtained a final consent judgment in a multi-year action against a trader for a private fund advised by a now-defunct firm.⁴⁸ The SEC's complaint, against the firm, trader, and others, alleged that the firm engaged in a fraudulent valuation scheme that resulted in the inflation of the value of the private funds the firm advised. The trader charged allegedly participated in the scheme to inflate the value of the securities. The SEC obtained a permanent injunction against the trader; the court did not order the trader to pay a civil penalty due to his financial condition. The others charged had settled in prior years.
- *Expense Reimbursement.* The SEC filed a complaint in 2020 against a former employee of a private equity firm, alleging he breached his duty of care to the funds he advised by submitting expense reports for phony business expenses that were ultimately paid by the funds. Following a bench trial, the district court found the defendant was liable under Section 206(2) of the Advisers Act because he was recklessly indifferent, and therefore negligent, as to which entity would pay for his expenses. The defendant appealed, and the Second Circuit reversed this past spring, finding that the defendant did not breach his duty of care to the funds or proximately cause their harm because the record demonstrated that a reasonable person in the defendant's shoes would not have known, nor reasonably foresee, that the funds would pay for his claimed expenses.⁴⁹
- *Revenue Sharing.* The SEC obtained final judgment in a multi-year litigation against a dually-registered broker-dealer and investment adviser, whereby the SEC alleged that the firm failed to disclose material conflicts of interest related to revenue sharing payments it received for certain client investments.⁵⁰ According to the complaint, the firm entered into a revenue sharing agreement with the broker that the firm required most of its clients to use and received revenue sharing payments from that broker when it invested client assets in certain classes of mutual funds. The SEC also alleged compliance failures. The final judgment orders the adviser to pay over \$65 million in disgorgement, representing the difference between the revenue sharing payments it received from investing clients' assets in higher-cost mutual fund share classes and what its revenue sharing would have been had the clients' assets been invested in lower-cost share classes of those funds, as well as approximately \$21 million in prejudgment interest and a \$6.5 million civil penalty.
- *Custody Rule.* The SEC filed a complaint against a New York-based investment adviser alleging that the firm advised client assets maintained by an Australian affiliated entity under common control and failed to comply with the custody rule's requirement that it obtain or receive from the Australian entity an annual internal control report from an independent public accountant.⁵¹ The SEC's complaint also alleged that the adviser breached its fiduciary duties by failing to disclose fully and fairly the conflicts of interest and material risks resulting from the Australian entity's use of client assets. The litigation is ongoing.

Compliance Failures

The SEC continues to bring actions against investment advisers for compliance failures, including standalone compliance failures. Compliance failures are routinely identified during the course of registrant examinations.

For example, the SEC charged an adviser with failing to implement policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules by failing to conduct compliance training for all supervised persons, failing to conduct spot checks of books and records, and failing to conduct periodic inspections of the principal places of business of its relying advisers, despite requiring such activities in its policies and procedures.⁵² The SEC's order noted that certain compliance deficiencies were identified during an examination. To settle the charges, the adviser agreed to pay a \$150,000 penalty, with the SEC's order noting the adviser's remedial acts and cooperation.

⁴⁸ Link [here](#).

⁴⁹ Link [here](#).

⁵⁰ Link [here](#).

⁵¹ Link [here](#).

⁵² Link [here](#).

CONTACTS

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

W. Hardy Callcott , Partner	+1 415 772 7402, hcallcott@sidley.com
Stephen L. Cohen , Partner	+1 202 736 8682, scohen@sidley.com
Chuck Daly , Partner	+1 212 839 6727, charles.daly@sidley.com
Ranah Esmaili , Partner	+1 202 736 8742, resmaili@sidley.com
Lara Shalov Mehraban , Partner	+1 212 839 5551, lmehraban@sidley.com
Ashley C. Pfeiffer , Counsel	+1 212 839 8629, apfeiffer@sidley.com
Sarah K. Gromet , Managing Associate	+1 212 839 5717, sgromet@sidley.com

Sidley Austin LLP provides this information as a service to clients and other friends for educational purposes only. It should not be construed or relied on as legal advice or to create a lawyer-client relationship. Readers should not act upon this information without seeking advice from professional advisers. In addition, this information was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding any U.S. federal, state or local tax penalties that may be imposed on such person.

Attorney Advertising—Sidley Austin LLP, One South Dearborn, Chicago, IL 60603. +1 312 853 7000. Sidley and Sidley Austin refer to Sidley Austin LLP and affiliated partnerships, as explained at www.sidley.com/disclaimer.

© Sidley Austin LLP