SEWARD & KISSEL LLP

# THE PRIVATE FUNDS BULLET REPORT

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## Business Planning, Structural, Legal, Regulatory & Compliance Developments

- On January 28, 2016, the SEC announced that QED Benchmark Management, L.L.C. ("QED Benchmark") and Peter Kuperman, its founder, agreed to settle charges that they misled investors about a fund's investment strategy and performance. The order stated that (i) QED Benchmark avoided disclosing heavy trading losses to investors by using a misleading mixture of hypothetical and actual returns when providing the fund's performance history and (ii) after obtaining millions of dollars from investors based on these misrepresentations, deviated from its stated investment strategy by pouring most of the fund's assets into one penny stock and made misleading and incomplete investor disclosures about the value/liquidity of the investment. The order found QED Benchmark and Mr. Kuperman in violation of the antifraud provisions of various securities laws. In addition to reimbursing fund investors $2.88 million, Mr. Kuperman agreed to pay a $75,000 penalty and be barred from the securities industry. In the release accompanying the order, SEC New York Office Director Andrew Calamari noted that "investment advisers must be completely candid when disclosing two key features that investors rely upon when making investment decisions: investment strategy and historical performance."

- On February 11, 2016, FINRA announced that it had barred two brokers from the securities industry for fraud in connection with hedge fund sales. FINRA's investigation found that Timothy S. Dembski and Walter F. Grenda made material misrepresentations and omissions to lead investors to believe that a hedge fund was a "growth" fund based on a computer algorithm that automatically included risk protections and stop-losses to limit losses; in reality, the fund was a highly speculative investment, where the fund's CIO had complete control over investments and the manager was not obligated to follow the computer algorithm. FINRA found that when marketing the fund, Dembski and Grenda distributed a private placement memorandum that they knew contained material misrepresentations about the CIO's professional experience. Dembski and Grenda settled with FINRA without admitting or denying the charges.

- On April 18, 2016, the Financial Stability Oversight Council ("FSOC") released its "Update on Review of Asset Management Products and Activities" and announced that it is creating an interagency working group that will share and analyze relevant regulatory information to better understand whether certain hedge fund activities might pose potential risks to financial stability. More specifically, the working group will (i) use regulatory/supervisory data to evaluate the use of leverage in combination with other factors—such as counterparty exposure, margin requirements, underlying assets, and trading strategies—to assess potential risks to financial stability; (ii) assess the sufficiency and accuracy of existing data and information for evaluating risks to financial stability, and consider how the existing data might be augmented to improve the ability to make such evaluation; and (iii) consider potential enhancements to, and the establishment of, standards governing the current measurements of leverage, including risk-based measures. The working group is aiming to report its findings to the FSOC by the fourth quarter. If the working group identifies risks to financial stability, the FSOC will consider what actions regulators can take using existing authorities, assess whether existing regulatory/supervisory tools are sufficient to address risks, and evaluate whether additional authorities are needed for market regulators or other supervisory agencies.

- On April 19, 2016, the SEC announced actions against two California-based investment advisers for cherry-picking profitable trades. The SEC alleged that from January 2010 to August 2014, Larry Phillips and his firm TPG Advisors, LLC ("TPG") systematically allocated profitable trades to at least six favored accounts held by clients with a personal connection to Mr. Phillips and allocated unprofitable trades to disfavored client accounts, despite warnings from TPG's third-party broker. The matter is pending and will go before an administrative law judge. Separately, the SEC found that Bruce A. Hartshorn, founder of Hartshorn & Co., Inc., disproportionately allocated profitable trades to proprietary accounts and unprofitable trades to clients, reaping $109,516 in ill-gotten gains. Hartshorn agreed to a cease-and-desist order, to pay $189,552 in penalties and to be barred from working as an investment adviser.

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