Client Update

SEC Charges Exempt Reporting Adviser's CCO for False Statements in Forms ADV

HONG KONG
Andrew M. Ostrognai
amostrognai@debevoise.com

LONDON
Sally Gibson
sgibson@debevoise.com

Geoff Kittredge
gkittredge@debevoise.com

NEW YORK
Jonathan Adler
jadler@debevoise.com

Andrew M. Ahern
amahern@debevoise.com

Erica Berthou
eberthou@debevoise.com

Jordan C. Murray
jcmurray@debevoise.com

David J. Schwartz
djschwartz@debevoise.com

Rebecca F. Silberstein
rfsilberstein@debevoise.com

WASHINGTON, D.C.
Kenneth J. Berman
kjberman@debevoise.com

Julie M. Riewe
jriewe@debevoise.com

Ada Fernandez Johnson
afjohnson@debevoise.com

The U.S. Securities and Exchange Commission ("SEC" or the "Commission")on January 19, 2017 filed its first-ever action against the Chief Compliance Officer ("CCO") of an exempt reporting adviser. The Commission filed a settled order against Susan M. Diamond ("Diamond"), CCO of Saddle River Advisors, LLC ("SRA"), for making untrue statements in Forms ADV SRA filed with the Commission.[1] In doing so, the Commission makes clear that it will continue to charge CCOs – including CCOs of exempt reporting advisers – for violations related solely to their compliance function in certain circumstances.

SETTLEMENT ORDER

According to the SEC's order, SRA has been an exempt reporting adviser since June 2013 and has $84.4 million in assets under management. Diamond was responsible for the preparation of SRA's 2014 and 2015 Forms ADV. In these forms, Diamond allegedly falsely represented that three private funds advised by SRA had undergone annual audits; that the audit reports were prepared in accordance with the GAAP; and that the audited financial statements would be distributed to investors. As a result, the Commission found that Diamond willfully violated Section 207 of the Investment Advisers Act of 1940 ("Advisers Act").

Diamond agreed to pay a $15,000 penalty and to a nine-month suspension from being associated with, among others, any investment adviser or serving in certain capacities with respect to a registered investment company. In addition, in a more unusual and punitive remedy, following the suspension and prohibition, she will be prohibited from acting in the securities industry in certain managerial and compliance capacities (including from working in a

[1] *In the Matter of Susan M. Diamond*, Exchange Act Rel. No. 79848 (Jan. 19, 2017).

compliance capacity, or as a partner, officer, branch manager, or director of any investment adviser or broker dealer).

ANALYSIS

This settled action is interesting for two reasons. First, it is unusual for the SEC to charge an associated person of an exempt reporting adviser (in this case, an adviser that acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million). While such advisers are not registered investment advisers, they are required to file Part 1A of Form ADV with the SEC, are subject to certain Advisers Act rules, and are subject to examination by the SEC.

Second, the SEC is continuing to focus on CCO liability related solely to the execution of the compliance function (in addition to instances in which a CCO is affirmatively involved in misconduct unrelated to the compliance function or has obstructed or misled SEC staff). Here, the Commission did not allege that Diamond knew that the relevant Form ADV statements were untrue, presumably because the SEC did not have such evidence. Rather, the order alleges only that Diamond was "*in a position* to answer questions on the Forms ADV related to SRA's financial statements, given that she had signatory authority over the SRA Funds' bank accounts, and … responsibility for making accounting entries into the general ledger [for SRA and the SRA Funds] . . . ."[2]

Under the framework the SEC staff (and SEC Commissioners) has articulated for CCO liability – i.e., when a CCO fails to perform his or her responsibilities diligently, in good faith, and in compliance with the law[3] – the Commission must have determined that Diamond, in making the untrue statements, failed to carry out her CCO responsibilities diligently. This conclusion is troubling, however, given that CCOs are conceivably "in a position" to answer accurately a broad array of questions, and the Commission appears to be taking the view that when a CCO is simply in such a position and fails to respond accurately – even when the CCO does not know that his or her statement is false – personal liability will attach.

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[2] Exchange Act Rel. No. 79848, ¶4 (emphasis added).

[3] SEC Commissioner Luis A. Aguilar, *The Role of Chief Compliance Officers Must be Supported* (Jun. 29, 2015), *available at* http://www.sec.gov/news/statement/supporting-role-of-chief-compliance-officers.html; SEC Commissioner Daniel M. Gallagher, *Statement on Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7,* (Jun. 18, 2015), *available at* http://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html.

KEY TAKE-AWAYS

The SEC's case against an exempt reporting adviser's CCO underscores the expansive approach the SEC is taking toward CCO liability. In this instance, the case confirms that CCOs, including CCOs at exempt reporting advisers, should take steps to confirm that the responses to Form ADV are accurate.

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Please do not hesitate to contact us with any questions.