PINE ADVISOR SOLUTIONS www.pineadvisorsolutions.com

Quarterly Newsletter

Brain Teaser Question 💡
What comes once in a minute, twice in a moment, but never in a thousand years?

Answer at the end!

Q4 2024

In This Issue

In October we had the pleasure of bringing together our remote Distribution Services team members together at our Denver HQ!

I. ETF Basics: Part I

This article is the first of three parts, aiming to provide a fundamental overview of exchange traded funds ("ETFs"), including what they are, and how to launch and run one. There's no doubt that ETFs have been garnering many headlines and gathering lots of assets. In this article series we will discuss the ins-and-outs of the wrapper that has been the pique of interest, offering a comprehensive look at both the advantages and considerations involved in ETF investing.

First, we will look behind the ETF structure, and answer questions like how it compares to traditional mutual funds, who are the actors participating, and what are the potential benefits of using the ETF for investing. By exploring the mechanics and key legislation related to ETFs, we aim to clarify their unique features and the role they can play within a diversified investment portfolio.

Exchange-traded funds and mutual funds are both popular investment vehicles with similarities in structure and regulations but significant differences in how they operate, are accessed by investors, and manage costs. ETFs, which have grown substantially in popularity since the SEC's Rule 6c-11 was adopted in 2019, now offer a streamlined path for issuers through reduced barriers to entry—such as lower legal fees, faster market entry, and flexible seeding amounts.

Both ETFs and mutual funds may be registered under the Securities Act of 1933 and the Investment Company Act of 1940, or in some cases, under only one of these acts. For years, ETFs required specific exemptive relief to operate similarly to mutual funds in structure and function Further regulatory clarity came with Rule 18f-4, focusing on derivatives used within these funds.

Structural Similarities and Differences

Like mutual funds, ETFs are registered funds that contain a basket of securities under a single ticker and calculate Net Asset Value ("NAV") at the end of each trading day. However, there are key distinctions between the two:

1. Trading Mechanism

- **Mutual Funds**: Mutual funds trade once per day at the NAV calculated after the market closes. When shareholders purchase or sell shares, these shares are created or redeemed by the fund itself, requiring cash transactions that trigger buying or selling within the fund's portfolio.

- **ETFs**: ETFs trade on an exchange throughout the day, enabling investors to buy and sell shares at market prices. Shares are created or redeemed in large blocks by institutions, who then distribute them to market makers for bid-ask posting. This arbitrage mechanism allows market prices to stay close to NAV.

2. Creation and Redemption Process

- **Mutual Funds**: Shares are typically purchased in cash, leading to transactional activity within the fund to align holdings with investor demand.

- **ETFs**: Allow for in-kind transfers (the exchange of securities instead of cash), creating tax efficiency by passing any capital gains tax liability to the Authorized Participants, rather than impacting the fund's shareholders.

3. Share Classes and Minimum Investment

- **Mutual Funds**: Offer multiple share classes, often requiring different investment minimums and fee structures.

- **ETFs**: Typically have a single share class with a minimum investment of one share, plus standard brokerage fees, providing uniform access for investors.

Benefits of ETFs for Investors

The structural differences outlined above grant ETFs distinct advantages over mutual funds:

- **Trading Flexibility**: Listed on exchanges, ETFs can be bought and sold throughout the trading day, unlike mutual funds, which trade only once per day. This enables investors to use different order types, such as limit or stop-loss, short sell, or buy on margin.
- **Cost Effectiveness**: ETFs generally have lower management fees, with no sales loads, contingent deferred sales charges, or redemption fees. Though ETFs often allow for a 12b-1 fee, they are rarely charged. While there are brokerage fees, overall costs for ETF investors tend to be lower.
- **Tax Efficiency**: The in-kind creation and redemption process enables ETFs to minimize capital gains distributions. Shareholders owe taxes only upon selling their shares, rather than when the fund sells portfolio securities.
- **Transparency**: Many ETFs disclose their portfolio holdings daily before the market opens, supporting arbitrage and allowing investors greater insight into the fund's composition and market movements.

Conclusion

The enhanced regulatory framework, tax efficiencies, and trading flexibility offered by ETFs present significant advantages for fund issuers looking to enter the market with a competitive product. With reduced barriers to entry under SEC Rule 6c-11, issuers can more readily introduce ETFs that appeal to a broad investor base seeking cost-effective, transparent, and tax-efficient investment options. By understanding the distinctions between ETFs compared to other wrappers, issuers are well-positioned to design and deliver innovative ETF offerings that meet the evolving needs of today's investors.

Look out for Part 2 of this three-part ETF series in our Q1 2025 newsletter where we will explore the launch process for an ETF and Part 3 in our Q2 2025 newsletter will share our thoughts on what to consider when running an ETF. In the meantime, reach out to your PINE contact with any questions, and we can provide tailored insights and guidance based on your individual needs.

II. Fee Transparency in Private Equity: Navigating Investor Demands and Industry Standards

Rising Demand for Fee Transparency in Private Equity

Over the last decade, the conversation around transparency in private equity fees and expenses has shifted dramatically. Transparency has moved from a behind-the-scenes concern to a front-and-center issue. Regulatory pressures and the growing demands from a more sophisticated investor base—with help from the Institutional Limited Partners Association (ILPA) — have shed light on the complex costs behind private equity's seemingly straightforward "two and 20" model.

"It's hard to pinpoint exactly who initiated this shift," says Stephanie Pindyck Costantino, a partner at Troutman Pepper.

ILPA has been instrumental in these changes, issuing guidelines aimed at establishing standards across the industry. These guidelines have been embraced by many, reshaping the landscape of fee transparency.

Growing Complexity for CFOs

While increased transparency is a win for investors, it hasn't been without its challenges for CFOs. Blinn Cirella, CFO of Saw Mill Capital, recalls the simpler days of their first fund nearly two decades ago. "Back then, our limited partnership agreement (LPA) had maybe half a page dedicated to partnership expenses. Now, our most recent fund has at least five pages covering every possible cost, from cybersecurity to ESG."

The rise of environmental, social, and governance considerations is another complicating factor. ESG costs have become a major expense line and many investors desire (or require) ESG ratings and extensive reporting, but in some jurisdictions, these aren't regulatory requirements for a fund. This leave many wondering, "who should bear those costs?".

A Push Towards Industry-Led Solutions

Now that the *Private Funds Rules* are off the table, the industry is now tasked with developing its own best practices. ILPA is actively revising its template for quarterly fees and expenses reporting, aiming to set a voluntary standard for the industry.
Investors are continuing to push for more detailed reporting. As such, General Partners are getting more specific with the information they provide. Transparency in this space, as the SEC intended, appears to be here for the long haul. As private markets continue to evolve, the demand for openness around fees and expenses will only grow, leading the way toward a more transparent and accountable future for the industry.

III. The Importance of a Comprehensive Anti-Money Laundering Program: Lessons Learned from TD Bank and What's Next from FinCEN

In recent years, financial institutions have faced increasing scrutiny over their anti-money laundering ("AML") practices, with significant penalties and reputational damage often following compliance failures. A recent case involving TD Bank highlights the crucial role AML programs play in safeguarding the financial system and ensuring regulatory adherence. The specifics of TD Bank's recent AML compliance challenges highlight the importance for investment advisers, and banks alike, to have a comprehensive and highly functional AML program.

TD Bank's AML Violations: A Cautionary Tale

TD Bank faced substantial fines and regulatory enforcement due to inadequacies in its AML program, with reported issues including failure to maintain adequate transaction monitoring, failure to report suspicious activities promptly, and weaknesses in its customer due diligence procedures. The penalties for these oversights not only underscore the financial cost of non-compliance but also reveal the damage such lapses can do to an institution's reputation.

For instance, TD Bank's case demonstrates the consequences of insufficient transaction monitoring, a core element of any AML program. Effective monitoring is essential for identifying unusual transaction patterns that can indicate money laundering activities. TD Banks's inability to address deficiencies in this area allowed suspicious transactions, to the tune of $600 million, go undetected and unreported, creating vulnerabilities across the financial system.

Strengthening AML Compliance: Essential Safeguards for RIAs and ERAs

AML programs are essential for mitigating financial and reputational risks, as breaches can erode public trust, impacting customer loyalty and market value. Not to mention the regulatory fines can be extremely costly. The proposed rule by the Financial Crimes Enforcement Network ("FinCEN"), published on July 3, 2024, emphasizes the critical importance of AML programs for Registered Investment Advisers ("RIA"s) and Exempt Reporting Advisers ("ERA"s) by including certain investment advisers in the definition of "financial institution" under the Bank Secrecy Act ("BSA"). An increasing number of RIAs and ERAs have become potential targets for money laundering schemes and this fact has not gone unnoticed by regulators.

A robust AML program helps prevent such vulnerabilities by establishing safeguards that deter illegal financial activities. Compliance with these stringent requirements under the Bank Secrecy Act and the Patriot Act is essential, as non-compliance risks severe penalties. This regulatory expansion underscores the necessity for RIAs and ERAs to adopt risk-based AML practices, ensuring the security of the financial system and the protection of their clients. Moreover, fostering a culture of compliance within financial institutions signals a commitment to ethical practices, reduces risks of regulatory lapses, and enhances the detection and management of suspicious activities, protecting both the institution and the broader market.

AML Requirements and Accountability in FinCEN's Proposed Rule

The proposed Rule's key elements include mandatory risk assessments to identify and address money laundering and terrorist financing threats, alignment with national AML priorities, and establishing essential program components, such as internal controls, a designated compliance officer, ongoing employee training, and independent program testing.

Additionally, the Rule extends Suspicious Activity Report ("SAR") filing obligations to RIAs and ERAs, requiring them to monitor and report potential suspicious transactions as part of their AML obligations. The Rule also recognizes the potential reliance on third-parties for AML support; however, it underscores that RIAs and ERAs maintain ultimate responsibility for the program's effectiveness. This delegation requires robust contractual oversight, ensuring that third-parties meet regulatory standards while the institution retains accountability. In the Securities and Exchange Commission's National Compliance Seminar on November 7, 2024, it was impressed upon Chief Compliance Officers to get started now reviewing third-party contracts to ensure timely compliance. By implementing these requirements, the Rule aims to

enhance the resilience of the financial system against illicit activities through a risk-based approach to AML compliance.

Such proactive measures can help institutions stay ahead of compliance challenges and mitigate risks associated with lapses, particularly as regulatory bodies like the SEC and FinCEN use patterns of industry non-compliance as grounds for stricter rulemaking.

IV. Cybersecurity in the Investment Space

Investment firms manage vast amounts of personal and sensitive financial information, making them prime targets for criminals. With the increasing sophistication of cyberattacks and the impact such attacks can have in the investment industry, the SEC continues to prioritize ensuring firms have adequate cybersecurity measures in place to safeguard information stored on an investment firm's systems. Developing comprehensive policies and procedures that address information protection, along with ensuring employees understand and adhere to the cybersecurity policies and practices your firm has implemented, are essential components of an effective cybersecurity program.

When it comes to cybersecurity, each employee plays a critical role in protecting the information at their organization. Safeguarding data is a team effort, and it is critical for each employee to understand their role in securing data they may possess. Confirming that you are informed on your firm's information security policies and know how to escalate incidents before they become major incidents is imperative while working in the investment industry.

Oftentimes, we overlook these simple, yet critical steps for staying safe online. Taking the below steps can ensure you are putting your best foot forward in the online world:

1. **Use Strong and Different Passwords:** Using the same password for all your logins has the potential for information across different platforms to become easily compromised if your single password is stolen. Using a password manager is a great tool to assist with storing and safeguarding multiple robust passwords to use, and regularly interchanging your passwords different logins can prevent unauthorized use of one of your passwords from leading to a larger data compromise.
2. **Use Multi-Factor Authentication (MFA) When Possible:** Adding a second layer of identity verification before access to sensitive information is granted provides another layer of defense against information compromise.
3. **Recognize and Report Phishing:** Social Engineering, including phishing, is a common way information becomes compromised in the financial industry. Oftentimes, criminals will attempt to use fake communications with the goal of luring you to act upon an urgent matter that involves disclosing sensitive information. This can include examples such as unanticipated requests for changes in wire instructions, disclosing banking details, requesting passwords via email, and other unusual requests. Criminals can also use phishing communications to trick you into clicking on malicious links or downloading malware onto your hardware device. Ensuring you are reviewing emails with

skepticism to determine validity before acting is a critical action to prevent information incidents from occurring. Reporting suspected phishing emails is also a step you can take to prevent malicious activity from spreading within your firm's IT infrastructure.

4. **Update Software Regularly.** Keeping your systems and anti-virus software up-to-date fixes issues and improves security for your devices. Criminals often look for gaps in system security – regularly updating your software ensures these gaps are addressed before criminals can exploit them.

Tips When Working Remotely

Working remotely poses its own set of challenges and cyber-related risks. Ensuring you take appropriate steps to mitigate risks when working outside the office is an important feature in the post COVID-19 world. Making your home workspace an extension of your office workspace in terms of cybersecurity measures helps prevent data from being compromised when you are outside the office. Below are recommendations for keeping your remote working space secure:

1. **Lock Up and Shred Sensitive Documents.** USB drives, papers, and notes may contain confidential data. Safely storing these physical items in a locked area when not in use can help prevent potential intruders from compromising sensitive data contained on these items. Additionally, shredding documents when you intend to discard the papers helps prevent sensitive data from being dug up in the trash can later by would-be criminals.
2. **Lock Device Screens When You Walk Away.** Whenever you leave your work devices unattended, you should lock your device screen before information can again be accessed. When working outside the office, you never know who may be trying to gain access to your devices; keeping your devices locked when not in use can prevent unauthorized sign-ins.
3. **Keep Your Software Up-to-Date.** As mentioned, criminals are continuously evolving the ways they can breach your software safeguards. Security precautions need to be updated in response to gaps criminals may have identified. Regularly updating your software and systems is an important step to preventing criminals from exposing potential gaps in your IT system's security.

Managed IT Service Providers

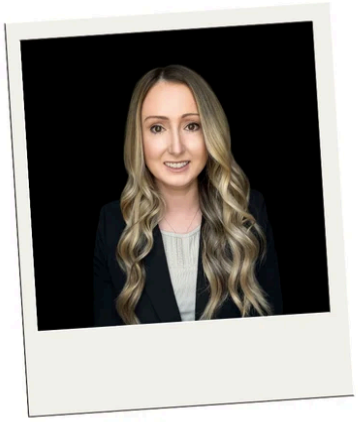
Engaging a managed IT service provider offers several key advantages for investment firms. IT service providers can provide specialized expertise in maintaining a firm's IT infrastructure and can assist with ensuring optimal performance in your systems. Managed IT service providers can also provide competence in understanding the complexities of cybersecurity and mitigating ongoing and emerging cyber threats in the financial industry. Managed IT service providers often offer 24/7/365 support and monitoring, which ensures that any technical issues are addressed promptly and appropriately. Should a cybersecurity incident arise at a firm, a managed IT service provider can also provide immediate assistance in detecting and mitigating cyber incidents before they escalate. In 2023, the SEC proposed Cybersecurity Risk Management Rule for Investment Advisers, Registered Investment Companies, and Business Development Companies which introduces regulatory notification requirements for significant cybersecurity incidents. A dedicated

IT service provider can be a valuable asset in helping investment firms meet timely response and reporting obligations imposed under the proposed rulemaking.

Managed IT service providers can also play a key role in supporting an investment firm's third-party oversight obligations, particularly in managing cybersecurity risks for service providers who exchange sensitive information with one another. Having technical expertise on information security, a managed IT service provider can assist investment firms in evaluating and ensuring the effectiveness of a service provider's control environment, verifying that information is appropriately safeguarded by the service provider.

Summary

Information security is an important aspect of compliance oversight that the SEC continues to emphasize as part of an investment firm's regulatory obligations. PINE encourages those who are interested to reach out to us to learn more about cybersecurity measures you can take to maintain a robust and compliant information security program.



Jerica Newbill - Director

PINE is excited to welcome Jerica as our Director of PFO services! Jerica brings years of experience and expertise to the team!

Prior Experience - Jerica has been active in the financial services industry since 2007. She has a background in mutual fund accounting, administration and financial reporting. Jerica has held positions in fund accounting operations and financial reporting roles over the span of her career at both Fundrise and State Street Bank.

Get to Know Jerica!
We asked Jerica a few questions to hopefully give our readers some insight into her background and personality.

1. Why did you join PINE?
The company culture and mission of working as a team with our clients, in addition to being able to work and collaborate with a small team of amazing people.

2. What is your favorite movie?
Home Alone

3. What are some of your favorite weekend activities?
Many of my weekends are spent at the soccer fields, cheering on my kids. Being outside, enjoying parks and hiking trails.

4. What is something you recommend everyone do or try at least once?
Travel to somewhere that you have always wanted to. It is such an amazing feeling once you have finally stepped foot on the place you have dreamed, researched, and planned for.

5. One last thing Jerica would like to share:
My family and I enjoy traveling together and seeing new places. This is a picture of us on a recent trip to Hawaii during our ATV adventure.

Get in Touch

Brain Teaser Answer 💡

The answer is **the letter "M."**

Empowering Growth,
Guiding Success

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