PINE ADVISOR SOLUTIONS www.pineadvisorsolutions.com

Quarterly Newsletter

Brain Teaser Question 💡

Q1 2025

I speak without a mouth and hear without ears. I'm invisible but can be seen. What am I?

Answer at the end!

In This Issue

Fun at Cheers to Chutes hosted by our friends over at Faegre Drinker!

I. Launching an ETF: Part 2

Overview

In Part 2 of our ETF article series, we turn the discussion towards a successful ETF launch. Areas such as timeline, key milestones, and the seeding and listing process will be covered. Fund conversions will be a topic here too, an issue PINE receives questions on regularly. Understanding the intricacies of launching an ETF is essential for those considering this wrapper for their strategy, as it can have significant implications for the fund's long-term viability and investor interest.

Check out Part 1 ETF Basics of this series in our Q4 2024 Newsletter.

Launching an ETF

Bringing an exchange-traded fund (ETF) to market starts with a well-defined idea. Sponsors must first identify their fund's strategy, differentiator, and target market while determining whether the ETF structure is the appropriate vehicle. Some investment strategies are not well-suited for ETFs due to liquidity and diversification rules, complexities of intraday trading, ease of pricing and hedging, and the inability to restrict fund purchases or redemptions. Beyond the investment strategy itself, a compelling story is essential—who is the target audience, what makes the product unique, when it will launch, where it will be available, how investors can access it, and where the product may fit in a portfolio. Because the market is more saturated than years ago, launching a fund does not guarantee demand; a well-thought-out distribution plan is necessary. The adage of “build it and people will come” has never been a recipe for success. Issuers must consider how they will reach their target audience, whether through wholesalers, whose activity can be challenging to track in an ETF model, through a digital-first approach driven by content and outreach, or some other approach.

Selecting key partners is another critical step. Issuers must decide whether to create a standalone trust or launch the fund within a series trust, a choice that affects the selection of service providers. A series trust, or white label platform, often comes with pre-selected partners, though sponsors can introduce new providers with board approval. Essential service providers include a custodian, transfer agent, and administrator (often a single firm) to maintain assets and records; legal counsel to handle regulatory obligations and SEC interactions; a statutory distributor to monitor primary market activity, review and approve marketing material, and enter into agreements with Authorized Participants; an auditor to certify financial statements; and market makers to ensure liquidity in secondary markets. If forming a new trust or advisory firm, additional personnel may be needed to act as officers, or act as support for these roles.

The timeline for launching an ETF varies based on the chosen structure. A fund launched within a series trust can achieve SEC effectiveness in as little as 75 days after the initial filing, depending on regulatory comments. Creating a new trust typically takes longer, often four to six months or more. Key milestones include selecting partners and service providers, submitting the initial SEC filing, responding to regulatory feedback, preparing for operational readiness, and seeding and listing the fund.

Unlike traditional investment products, ETFs enter the market through a seeding event, ensuring initial liquidity upon listing. Seeding involves the creation of a block of shares that are placed on an exchange, allowing liquidity providers to post bid-ask spreads and facilitate trading. The process begins when the Lead Market Maker (“LMM”) places a creation order through its preferred clearing Authorized Participant

("AP"), or a large institution contracted with the distributor. In exchange for cash or in-kind securities from the AP, the fund issues new shares, which are then distributed to the LMM for the opening auction. Once listed, the ETF trades like common stock, with investors buying and selling shares amongst themselves through brokers. When demand exceeds supply, market makers create additional shares through an AP, increasing the number of outstanding shares. Conversely, when selling pressure arises, market makers redeem shares, reducing the total share count.

Some issuers choose to bring an ETF to market through a conversion of existing assets, transitioning a mutual fund, separately managed account ("SMA"), or other pooled investment into the ETF structure. The goal is for investors to transition seamlessly, holding ETF shares with an equivalent total value the day following conversion. These conversions can often be executed in a tax-efficient manner, though they are subject to regulatory considerations. Benefits of conversion include immediate scale and trading volume, favorable breakeven profitability, potential use of an established track record for marketing and distribution, and potential tax and liquidity advantages for investors.

Conclusion

There are many ways to bring an ETF to market, but successful issuers typically follow a structured process. It all starts with an idea that seeks to fulfill investor demand in a way existing products do not. Careful selection of partners ensures a smooth launch and effective ongoing operations, culminating in a well-orchestrated seeding and listing event. However, launching the ETF is just the beginning—the real work lies in sustaining investor interest and growing assets under management.

Look out for Part 3 of this three-part ETF series in our Q2 2025 newsletter where we 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 situation.

II. The Private Fund Issuer Exemption – Once Again in the Spotlight

Overview

The U.S. Securities and Exchange Commission ("SEC") enforces regulations intended to maintain fair and transparent financial markets. One example of such regulation is SEC Rule 3a4-1, commonly known as the Issuer Exemption or the Safe Harbor Rule. The Safe Harbor Rule allows certain employees of an issuer to participate in selling securities without being considered brokers or dealers, effectively exempting them from the SEC's broker-dealer registration requirements. For example, certain investment advisor representatives and employees, such as partners, officers, and directors, are generally permitted to solicit investors without being registered with a broker-dealer. However, where investment advisor representatives or other associated persons' primary role is in a sales capacity, and commission is part of their compensation structure, registration is likely required. In addition to the actual rule, this topic was also highlighted in a 2013 speech by the SEC's Chief Counsel, Division of Trading and Markets.

Repercussions for Non-Compliance

It is well understood that the interpretation of the Safe Harbor Rule is nuanced and that private fund managers and issuers should seek the guidance of experienced counsel when determining whether their activities fall within the Safe Harbor Rule to avoid enforcement and fines. The SEC continues to focus on compliance with the Safe Harbor Rule as we have seen in recent cases. In January of 2025, the SEC settled charges against three investment adviser representatives for acting as unregistered brokers in selling membership interests in unregistered funds. The charges amounted to approximately $540,000 in disgorgement, prejudgment interest, and civil penalties. Moreover, the SEC settled charges against the firm that employed the representatives.

Perhaps the most notable SEC enforcement action occurred in 2013 against Ranieri Partners, a private equity firm. The SEC charged the firm for paying transaction-based fees (i.e., commission) to a consultant who solicited investors for their private fund without being registered as a broker. This action led to a $375,000 fine for the firm and the consultant was barred from the securities industry.

It is imperative that investment adviser firms engaged in marketing unregistered products adhere to the Safe Harbor Rule. Effective compliance means that firms are educated on the Safe Harbor Rule, its guidelines, and issuer exemption eligibility. As witnessed in the previously discussed SEC sanctions, violations of the Safe Harbor Rule have a material impact on investment advisor firms and their associated persons. Individuals and firms can be subject to fines and industry bars. Moreover, the negative impact of an enforcement action can be a permanent stain on a firm or individual's reputation.

Conclusion

Firms on the fence, or that are decidedly outside of the Safe Harbor Rule, have options concerning their private fund sales activity. They can hire a third-party solicitor that is registered with a broker-dealer, create a broker-dealer (a costly and time-consuming process), or outsource the function by registering its sales team with an experienced broker-dealer.

III. FASB Issues ASU 2023-07: Enhancing Segment Reporting and Disclosure Requirements

Overview

In November 2023, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2023-07, titled "Segment Reporting – Improvements to Reportable Segment Disclosures." This update expands on the

1997 segment reporting guidance that requires certain entities to identify and report on segments of their operating business.

ASC 280 defines an operating segment as a component of a public entity that engages in business activities from which it may recognize revenues and incur expenses, and has operating results that are regularly reviewed by the public entity's chief operating decision maker (CODM) to make decisions about resources to be allocated to the segment and assess its performance, and discloses its discrete financial information.

Effective for fiscal years beginning after December 15, 2023, and interim periods in fiscal years beginning after December 15, 2024, this update aims to enhance the frequency and detail of segment reporting, clarify certain terms and reporting methods and expand requirements of reporting expenses.

Key Provisions of ASU 2023-07

- **Disclosure of Significant Segment Expenses**: Entities must disclose, on both an annual and interim basis, significant segment expenses. Significant is clarified to be an expense that is regularly provided to the CODM and included in each reported measure of segment profit or loss.
- **Interim Disclosure Enhancements**: All existing annual disclosures about segment profit or loss must now be provided in interim periods, along with disclosures of significant segment expenses and other segment items.
- **Multiple Measures of Segment Profit or Loss**: Entities may disclose more than one measure of segment profit or loss, provided that at least one of the reported measures includes the segment profit or loss measure most consistent with Generally Accepted Accounting Principles (GAAP) measurement principles.
- **CODM Disclosure**: On an annual basis, entities must disclose the title and position of the CODM, along with additional reporting and processing disclosures.
- **Single Reportable Segment Entities**: Entities with a single reportable segment are required to apply all disclosure requirements of ASU 2023-07, as well as all existing segment disclosure and reconciliation requirements in ASC 280, on both an annual and interim basis.

Impacts of ASU 2023-07

ASU 2023-07 was introduced in response to stakeholder requests for more frequent and detailed reporting on the segment expenses of certain public entities. The update clarifies that segment reporting applies to all entities under ASC 280, expanding these requirements to include specific investment companies, such as regulated investment companies and business development companies. However, many investment companies, which typically operate as single reporting segments by the nature of their structure, now face new reporting requirements that may not be fully applicable. As many of these entities prepare for the December 31, 2024 reporting deadline, the industry is working to establish appropriate disclosures that address the new requirements while clarifying that many investment companies already comply with the existing reporting standards for single reporting segments. All public entities will need to carefully assess and implement the new disclosure rules to ensure compliance and fully capitalize on the benefits of enhanced transparency.

IV. Employee Spotlight

Lexi Vance - Organizational Development Officer

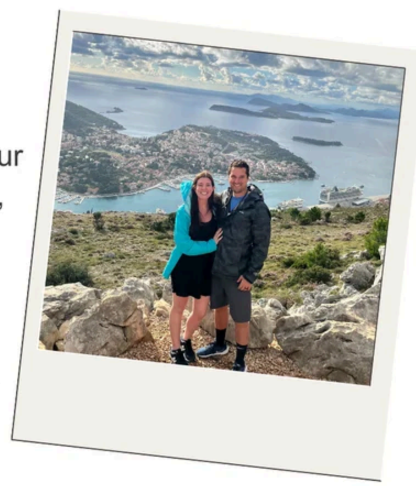
PINE is excited to introduce Lexi Vance as our Organizational Development Officer! Lexi brings years of experience and expertise to the team! She oversees talent acquisition, human resources, and employee engagement to strengthen organizational effectiveness and enhance team satisfaction.

Prior Experience - Lexi began her career as a teacher before transitioning into HR and talent management, where she found a passion for supporting people and organizations in achieving their full potential.

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

1. Why did you join PINE?
I joined PINE for the wonderful people and the opportunity to contribute to an organization experiencing incredible growth. Since I started in 2023, we've nearly doubled our team!

2. What is your favorite movie?
Bridesmaids—it never gets old!



3. What are some of your favorite weekend activities?
I love enjoying the Colorado outdoors with my husband and our Goldendoodle, Copper. We spend weekends camping, hiking, fishing, and paddleboarding.

4. What is something you recommend everyone do or try at least once?
Going for a quick swim in a cold alpine lake, especially after a long hike. It's a great way to refresh!

5. One last thing to share:
My husband and I got married last fall, and for our honeymoon, we explored the Croatian coast! A highlight was four-wheeling up Mount Srđ in Dubrovnik for the incredible views (see picture).

Get in Touch

Brain Teaser Answer 💡

The answer is **an echo.**