

Regulatory Compliance Watch

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PF LATEST NEWS

Little bark, lots of bite in SEC's priorities

'There have been a lot of very significant enforcement actions suggesting a strong focus on private funds,' Morgan Lewis partner Christine Ayako Schleppegrell says

The SEC's new exam priorities are fairly muted about private funds, but just because regulators aren't barking doesn't mean they're not biting, experts say.

Private fund managers, who had been featured players in previous years' priorities, don't even get a full page in fiscal 2025's update, released Oct. 21. Moreover, all of the worries that regulators point out—proper disclosure of business practices (including market volatility), the “accuracy of calculations and allocations of fees and expenses,” conflicts of interest as well as the adequacy of firm policies and “compliance with recently adopted SEC rules,” including the new Form PF and marketing rules—have been in priorities before and in greater detail.

No one thinks that means regulators are softening up on the industry.

“Between fiscal 2024 and 2025, they've become more boiler plate, but given the enforcement environment around private funds, it's hard to say that private funds are not a focus,” Morgan Lewis Partner Christine Ayako Schleppegrell tells RCW. “There have been a lot of very significant enforcement actions suggesting a strong focus on private funds. Those actions hit on the same policy objectives that were the foundation for the now-vacated private fund adviser rules.”

Tip of the iceberg

Indeed, multiple compliance sources tell RCW that they're reading the latest exam

priorities as merely the tip of the iceberg. However terse examiners have gotten in describing their priorities, they've gotten a lot more voluble in executing them, experts say.

It has become typical in recent years that exam staff ask for “all instances of valuation adjustments—write-offs, write-downs, partial realizations – and the impact on management fees,” says Meaghan Kelly, a partner at Simpson Thacher & Bartlett. “The staff will review in light of disclosures. That sort of initial scoping question is fairly new and has only been seen in the last couple years.”

When a federal appeals court struck down the SEC's new private fund rules earlier this year, some experts guessed that regulators might try to win through exams and enforcements what they had lost in the courts (RCW, June 17, 2024). Multiple compliance lawyers say that's happening already.

Consider, for example, annual compliance reviews. Current rules require every registered fund adviser to conduct an annual review. The aborted private fund rules would have required that fund managers document those reviews.

“I think it's worth noting that annual compliance reviews are increasingly an exam focus,” Kelly says. “Now the staff is asking, if they weren't documented as part of the ordinary course of business, for summaries to show that the review was in fact done.”

The marketing rule

Regulators are also focused on the marketing rule, Kelly and others say.

“While the reference to the marketing rule in the priorities was brief, the marketing rule has been squarely in focus of exams for the past two years and will continue to be in focus. Managers should pay special attention to incorporating the impact of sub lines in the presentation of performance in marketing materials per the FAQ from earlier this year. The references in the exam priorities often have embedded meanings and history, and the priorities are really tying all those things together,” says Kelly.

Fund managers should also be mindful of the marketing rule's substantiation requirements, Kelly adds.

“The rules don't require the contemporaneous documentation of substantiation, but you do have to show it upon demand,” she says. “Of course, it is often helpful if an adviser does keep contemporaneous records of the substantiation. Conducting mock exams or targeted testing is also helpful so you can go through the process and see where any holes might be including with respect to substantiation. I do think these exam priorities offer an opportunity for a CCO to train or retrain their staff on some of these priorities.”