

November 2017

Regulatory: SEC Exam Environment and Growing Expectations for ERAs

Panel:

Joshua Newville, Partner, Proskauer

Denise Marks, Partner and Chief Financial Officer, SV Health Investors

Marty Eng, Chief Financial Officer, Western Technology Investment

Proskauer 

SEC Oversight of ERAs – The Basics

- Exempt Reporting Advisers (Private Fund and VC Advisers)
 - Filing requirements apply
 - Exempt from most (but not all) Advisers Act provisions
- ERA's are not exempt from:
 - Form ADV Part 1A
 - Exams (not regular, but for cause)
 - General Anti-Fraud
 - Section 206 & Rule 206(4)-8
 - Pay-to-play Rules (Rule 206(4)-5)
 - Insider Trading (Section 204A – Policy)

Registered Advisers – Additional Steps

- *Examples:*
 - Required to file and deliver Firm Brochures (Form ADV Parts 2A or 2B)
 - Required to file a Form PF
 - Full Compliance Programs
 - Periodic SEC examinations
- Designing policies and procedures – not “boilerplate”
- Organizing and maintaining files
- Costs of compliance

SEC (OCIE) Examination Priorities for 2017

- Never-Before-Examined Investment Advisers
- Recidivist Representatives and their Employers
- Multi-Branch Advisers
- Cybersecurity
- Regulation Systems Compliance and Integrity (“SCI”)
- Anti-Money Laundering

SEC (OCIE) Examination Priorities for 2017

- Private Fund Advisers
 - “We will continue to examine private fund advisers, focusing on conflicts of interest and disclosure of conflicts as well as actions that appear to benefit the adviser at the expense of investors.”

What Can Prompt an SEC Examination?

- Comments and tips received directly from investors and registrants,
- SEC market monitoring efforts and systems,
- Data maintained in third party databases,
- Information reported in filings with the SEC,
- Information gathered through other SEC or regulatory examinations,
- Communications with other U.S. and international regulators,
- Interactions with registrants, industry groups and service providers outside of examinations, and
- Industry and media publications.

 (“Adviser”)
Information Request List

Please furnish the information listed below for the above referenced Adviser by _____. Unless otherwise indicated, please provide the requested information for the time period **January 1, 2016** through **September 30, 2017** (the “Examination Period”).

In order to efficiently process the material assembled for the staff’s review, please label the information so that it corresponds to the item number in the request list. If information provided is responsive to more than one request item, you may provide it only once and refer to it when responding to the other request item numbers. If any request item does not apply to your business, please indicate “N/A” (not applicable).

1. A copy of the Adviser’s organization chart showing the following:
 - a. ownership percentages and control persons;
 - b. a schedule or chart of all affiliated entities;
 - c. the structure by name and title of the management team; and
 - d. the structure by name and title of the compliance department.
2. Preferably in Excel - A list of all current employees, partners, officers and directors and their respective titles and responsibilities.
3. Names of any of the Advisers’ officers and/or directors who resigned during the Examination Period and information regarding the reason for their departure.
4. A list of all committees including a description of each committee’s responsibilities, meeting frequency, and a list of the members of each committee. State whether the committees keep written minutes.
5. Any threatened, pending and settled litigation or arbitration involving the Adviser or any “supervised person” (if it relates to the individual’s association with the Registrants or a securities-related matter) including a description of the allegations, the status, and a brief description of any “out of court” or informal settlement. If none, please provide a written statement to that effect.
6. A list of the names of any joint ventures or any other businesses in which the Adviser or any officer, director, or portfolio manager has any interest (other than their employment with the Adviser), including a description of each relationship and entity.
7. A copy of the brochure(s) and supplements (if any) distributed to current and prospective investors to satisfy the requirements of Part 2A of Form ADV. If Form ADV Part 2A is used please provide a copy, including Form ADV Part 2B.
8. Adviser’s balance sheet, income statement, cash flow statements, and general ledger (Preferably in Excel) as of its most recent fiscal year and the most current year to date.

9. For each private fund the Adviser manages or previously managed please provide a copy of the limited partnership agreement, operating agreement (between adviser and fund), and any fee agreements between deal partners/underlying investment and adviser/affiliate. (e.g. partnership agreement, private placement memoranda).
10. For each private fund with an outside administrator please provide the most recent administrator package.
11. A list of all acronyms and definitions utilized by the Adviser.
12. Preferably in Excel - Information regarding each private investment fund, including:
 - a. Name as shown in organizational documents (as amended).
 - b. Domicile (country).
 - c. Specific exemption(s) from registration under the Securities Act of 1933 and/or the Investment Company Act of 1940 upon which each fund relies.
 - d. Investment strategy (e.g., buyout, venture, mezzanine etc.).
 - e. If funds are part of a master/feeder fund structure, full name and domicile of each fund.
 - f. Number of investors and total assets as of **September 30, 2017**.
 - g. Amount, if any, of adviser’s equity interest in each fund as of **September 30, 2017**.
 - h. Amount, if any, of adviser’s affiliated persons’ interest as of **September 30, 2017**.
 - i. Date the fund began accepting unaffiliated investors.
 - j. Whether the fund is currently closed to new investors and the closing date.
 - k. Services the adviser or an affiliate (e.g., general partner, adviser, managing member, fund accounting) is providing.
 - l. Lock-up periods for both initial and subsequent investments.
 - m. Fund’s current phase (e.g., commitment, investment, management, exit);
 - n. The value of each fund’s account that was used for purposes of calculating its advisory fee for **July 2017** and **September 2017**;
 - o. The advisory fee charged for the last two billing periods: **July 2017** and **September 2017**.
 - p. Whether the fund pays a performance fee, the most recent account performance figures, and the performance fee amount charged for the two most recently completed billing periods;
 - q. Whether the fund pays carried interest and whether the fund is currently in-the-money or out-of-the-money for earning carried interest.
 - r. Whether the fund is currently in a clawback position and the amount of the clawback.
 - s. Amount of leverage, both explicit (on-balance sheet) and off-balance sheet (futures and certain other derivatives), used by the fund as of **September 30, 2017** as measured by the adviser for risk-management purposes.
13. Preferably in Excel - List of current and former investments made by each fund as of **September 30, 2017**.
 - a. Investment name;
 - b. Fund(s) in which the investment was made;

- c. Ticker symbol (if applicable);
- d. Date of original investment;
- e. Amount of original investment;
- f. Dates of additional investments;
- g. For each additional investment, the amount of the investment;
- h. name(s) and amount(s) of any co-investment(s);
- i. Date of first realization from the investment;
- j. Realized amount;
- k. Value of remaining investment/unrealized amount (if any); and
- l. Investment level gross IRR (if available).

14. For each private fund the Adviser manages, please provide the following for its most recent fiscal year end and through September 30, 2017:

- a. balance sheet;
- b. trial balance;
- c. detailed general ledger;
- d. cash receipts and disbursements journal;
- e. income statement; and
- f. cash flow statements.

15. Preferably in Excel - A list of investors in each fund managed by the Adviser during the inspection period including:

- a. Investor name and current balance, as of September 30, 2017;
- b. whether the investor is a related person, affiliated person, or a proprietary account;
- c. the type of account (e.g., individual, defined benefit retirement plan, registered fund, or unregistered fund);
- d. the name of the fund and strategy the investor is invested in;
- e. the value of each investor's account that was used for purposes of calculating its advisory fee for the most recent billing period.

16. Copy of the latest statements/reports sent to investors.

17. Audited financial statements for each fund for 2015 and 2016.

18. Compliance and operational policies and procedures in effect during the Examination Period for the Adviser and its affiliates.

19. Any written reviews completed by ACA Compliance.

20. Names of any companies for which employees of the Advisers or their affiliates serve as officers and/or directors, and the name(s) of such employees.

21. Any restricted, watch, or grey lists that were in effect for the Examination Period.

22. A list of all approved private investments held by employees of the Adviser during the Examination Period. The list should include, but is not limited to, the following:

- a. name of the employee;
- b. date of investment;
- c. name of investment;
- d. date of the Adviser's approval;
- e. amount invested; and
- f. employee role with private investment.

23. Names of companies for which employees of the Advisers or their affiliates, serve on creditors' committees, and the name(s) of such employees.

24. The names and location of all service providers and the services they perform for the adviser and the funds the adviser manages.

25. A list of co-investments made by any of adviser's employees, affiliates or other related parties in any portfolio holdings together with the funds. Please include in the list, the investor's name; the name of the investment; date of agreement to co-invest; co-investment amount contributed; and any subsequent contributions or withdrawals in the investment.

26. A list of rejected investment opportunities, associated expenses and the clients or other entities to which the expenses were allocated.

27. Copies of any side letters, side arrangements, or similar documents (including e-mails) or understanding that pertains to any contractual relationships involving privately offered funds.

28. Preferably in Excel - A list of all compensation and expense reimbursements received by the Adviser or its affiliates, besides management and performance fees, from the funds or the underlining investments in the following format:

- a. Date received
- b. Payer
- c. Amount
- d. Type (transaction fee, monitoring fee, monitoring fee acceleration, Board/Director Fee, other fee (please explain)).
- e. Amount credited to investors/funds

29. Documents concerning any revenue sharing between the Adviser and any third party, including but not limited to, agreement(s), total revenue sharing paid and/or received during the Examination Period, and correspondence.

30. Any written valuation policies and procedures.

31. A list of asset valuation methodologies used during the Examination Period.

32. A list of any valuation analyses or models used during the Examination Period.

33. Any third party valuation reports produced in the past two years, including but not limited to, the Cogent Valuation reports for the private fund(s).
34. A copy of the Adviser's engagement letter for valuation services with Cogent Valuation.
35. A list of members on the Valuation Committee.
36. Any minutes or notes from the Valuation Committee meetings.
37. Provide the account number and contact information (i.e. name, mailing address, phone number and e-mail address) for the entities that maintain custody of the cash and securities of each client's account during the Examination Period. For private fund clients, please be sure to include all bank and brokerage accounts. For any securities that were not maintained with a qualified custodian, please include a description of the security, security name, location of the security, and the name of the clients who held such securities. For purposes of this request, you may exclude any assets held pursuant to a derivative or swap contract. Such information, if applicable, may be requested later. The staff may request that the custodian(s) of specific client accounts provide the staff directly with a confirmation of all positions, including cash, short positions, and loans, held as of particular dates.

OCIE Exam Requests

- Dealing with the SEC's initial request
 - Narrow the Request
 - “Reasonableness” standard
 - Privilege
 - Respect the privilege
 - Privilege Logs
 - Confidentiality
 - FOIA Requests

Best Practices for On-Site Exams

- Preparation
 - Try to identify type/purpose of exam (routine, sweep, for cause)
 - Review SEC/NFA request lists; have documents ready
 - Importance of documenting annual compliance reviews
- Role of CCO
 - Primary point of contact
- Prepare for initial meetings/interviews
 - Importance of setting the right "tone at the top" up front
 - Have introductory firm presentation ready

Best Practices for On-Site Exams

- Witness preparation:
 - Make sure employees are familiar and comfortable with the compliance procedures relevant to their positions and responsibilities.
 - Employees do not need to know everyone else's job.
 - If you don't know or don't remember – don't speculate.
 - Don't be afraid to ask questions
 - GC/CCO should participate and be ready to step in to request clarification of questions, clarify responses, etc. as needed

Key Issues Raised in Recent SEC Exams

- Fee and expense disclosure
 - Allocation of expenses to or among client accounts
- Valuation / Performance
 - Policies and procedures; disclosures
 - Calculation and accuracy
 - Statements in marketing materials
- Annual compliance review
- MNPI

Moving from Exam to Enforcement

- Enforcement referral process
 - Interactions between OCIE and Enforcement
 - Types of cases referred
- Formal investigations
 - Process, generally
- Covert investigations

Significant Areas of Enforcement Focus

1. Fee & Expense disclosures

- Key type of case that the AMU focuses on
 - Example: operating partners
- Platinum Equity
 - SEC alleged that PE adviser charged undisclosed broken deal expenses
- SLRA/Landress
 - SEC alleged adviser took unapproved fees to pay a related party.
 - Fund's LPAC was asked but did not consent

Significant Areas of Enforcement Focus

2. Valuation / Performance Advertising

- September 2017 OCIE Risk Alert highlighting common performance advertising deficiencies
- SEC cases: Focus on issues “around” valuation
- Enviso Capital
 - Valuation error = misleading performance = inflated fees = GAAP violation = Custody Rule violation

Significant Areas of Enforcement Focus

3. Insider Trading

- Focus on individuals
- Entity MNPI policies and procedures
- Potential for creative resolutions:
 - Maybe more creative resolutions
 - Individuals charged with fraud
 - Firm settles under Section 204A of Advisers Act - insufficient policies;
 - penalty in the amount of the alleged trading profits

Significant Areas of Enforcement Focus

4. Pay-to-Play

- Pay-to-play sweep (January 2017)
 - SEC settlements with ten advisers including VC advisers arising out alleged pay-to-play violations
 - Monetary penalties ranging from \$35,000 to \$100,000
- TL Ventures Enforcement Action (2014)
 - 2011: Covered associates contribute \$2.5k to mayor's campaign and \$2k to governor's campaign; Settlement: \$300,000

Significant Areas of Enforcement Focus

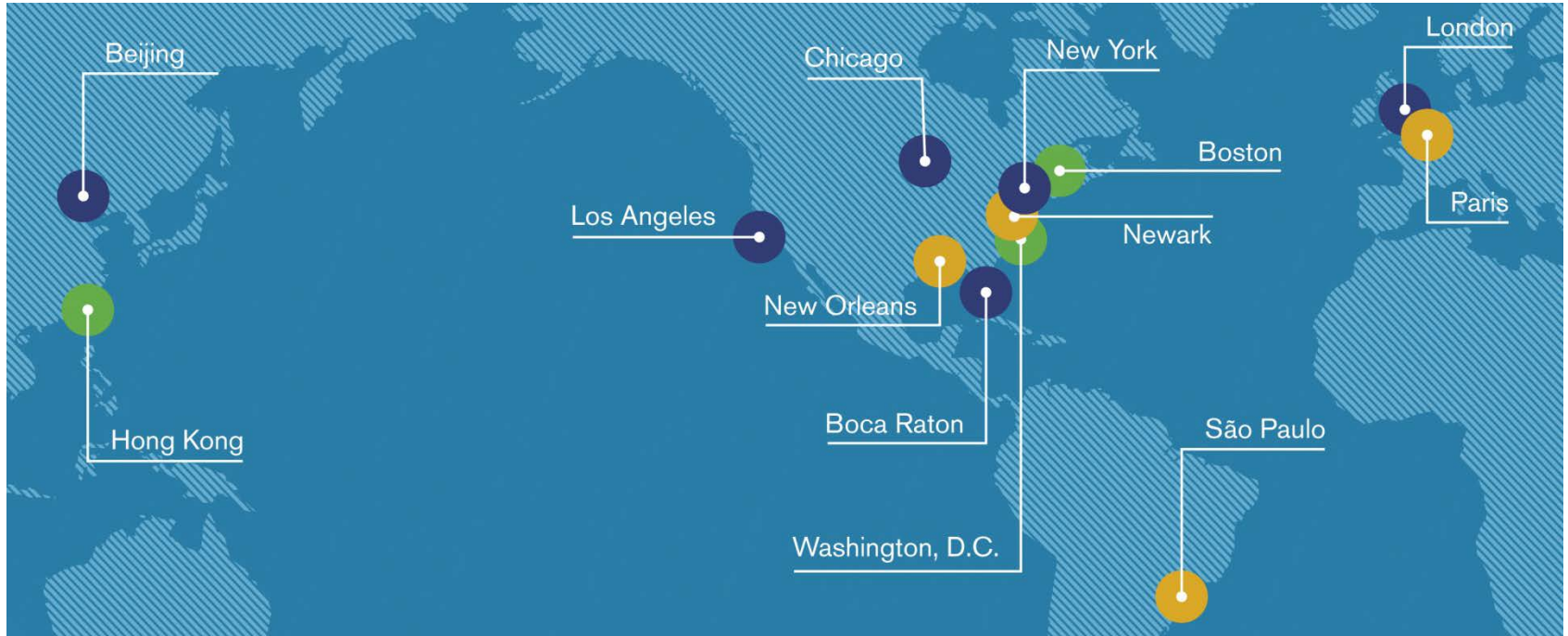
4. Pay-to-Play (cont'd)

- Landmines abound
 - Not only RIAs, but also ERAs
 - Who is a “Covered Associate” and an “Official”
 - PACs
 - Hiring/Promotions

Making Sense of the SEC's Approach

- The SEC is not regulating by imposing a comprehensive set of “regulations” or a “code”
- Instead, the SEC is creating “community standards” through a combination of examinations, enforcement proceedings, and speeches
- Each enforcement proceeding and public statement is the equivalent of a “fence post”
- By stringing together a series of enforcement proceedings, the SEC has developed boundaries on acceptable practices

Proskauer's Global Presence





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