Compliance Outreach Program
National Seminar
For Investment Adviser and Investment Company
Senior Officers

January 30, 2014
Welcoming Remarks

Chair White
SEC Standard Disclaimer

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Introductory Remarks

Drew Bowden
Norm Champ
Andrew Ceresney
Program Priorities

Jane Jarcho
David Grim
Julie Riewe
Question & Answer Session

(Advisers with $1 Billion or Less in RAUM)

FY 2014

% of IA Firms by Size

- $500M - $1B: 12%
- <$500M: 62%
- >$1B: 26%
Question & Answer Session

Kristin Snyder
Maureen Dempsey
William Delmage
Igor Rozenblit
John Farinacci
Daniel Kahl
Holly Ceci-Hunter
BREAK
Private Fund Adviser Topics

Ashish Ward
Alpa Patel
Igor Rozenblit
James Capezzuto
Barbara Burns
Private Fund Registrant Universe – SEC-registered advisers:

Total of 4,136 Advisers and $8,205 billion Gross Assets
Private Equity and Hedge Funds

Private Fund Registrant Universe – exempt reporting advisers:

Total of 2,520 Advisers and $2,418 billion Gross Assets
Private Equity and Hedge Funds

Some Key Focus Areas in Presence Exams*:

1. Investment Conflicts of Interest
   - Personal and Affiliates’ Transactions (private equity)
   - Allocations of Investment Opportunities (private equity and hedge funds)
   - Fees to GPs/advisers and expenses to funds/portfolio companies

2. Marketing and Fund Raising
   - Placement Agents (private equity and hedge funds)
   - Performance marketing (hedge funds)

3. Valuation
4. Custody

*Over 250 Presence Exams completed to date, with significant findings in each of these focus areas
Private Fund Adviser Topics

Private Equity Regulatory Concerns

Igor Rozenblit
Concerning Industry Structures and Norms

**Fund Structures**
- Vague / Broad LPAs
- Few Information Rights
- Long Lockups
- High Barriers to Action for Disgruntled LP

**Norms**
- Acceptance of Poor Transparency
- GPs Have Operating Control of Port Cos.
- LPs Understaffed and Outgunned
- Inherent Conflicts of Interest

**Trends**
- Industry Consolidation
- Increasing Importance of Separate Account
- Decreasing Reliance on Carry
- Cost Pressure / Expansion of Back Office
Regulatory Concerns

- Norms
  - Expense Shifting
  - Ancillary Revenue
  - Favoritism
  - Marketing

Fund Structures

Trends
Expense Shifting

**Issue:**
Moving expenses out of management company and into funds without proper disclosure and LP consent.

**Examples:**
- Use of related party service providers which appear to be full members of a manager’s team (e.g. operating partners, senior advisers, captive consulting firms).
- Automating standard processes with costs paid by funds (SAAS).
- Outsourcing traditional back office functions to related parties (i.e. accounting, legal, risk).
Ancillary Revenue

**Issue:** Generating additional revenue while reducing available cash to funds without proper disclosure and LP consent.

**Examples:**

- Monitoring fee accelerations esp. the inclusion of evergreen features in monitoring agreements.

- Use of related party service providers that kick cash back to manager (e.g. some captive consulting firms, some group purchasing programs)
**Favoritism**

**Issue:** Favoring certain clients or funds or favoring certain investors without proper disclosure.

**Examples:**

- Co-Investment allocation (Rule 206(4)-8 and other antifraud provisions might be violated without adequate disclosure)

- Improperly giving mezzanine/lending business to favored investors.

- Primary investments made to support a secondary or co-investment business.
Issue: Managers stretching for capital may overstate or misstate material facts.

Examples:

- Improperly constructed interim valuations (Oppenheimer matter, Jenkinson and Barber / Yasuda papers confirm concern).

- Improper attribution disclosures esp. in cases of departing team members.

- Key investment team departures esp. in cases of changes occurring immediately after closing.
Compliance Considerations

- Senior support is key -- ensure management understands costs of an enforcement action.
- Integrate into business -- attend key meetings.
- Understand your business and focus on mitigating your conflicts of interests.
- Design robust disclosures where eliminating or otherwise mitigating conflict is not possible.
Perennial and New Risks to be Mindful Of:

1. Other Investment and Trading Conflicts (e.g., Soft Dollars and Fund Redemptions/Liquidations)
2. Controlling Non-public Information about Publicly Traded Companies (e.g., use of expert networks)
3. Controlling Non-public Information about Clients/Funds (e.g., collaborating on ideas with other managers)
4. Form PF Reporting
5. CCO Knowledge/Authority and Tailored/Robust Compliance Program
Hot Topics for Discussion/Debate:

1. Investment Conflicts of Interest
   • Why care about co-investors?
   • What is considered a “fair” allocation of investments or expenses?
   • As a fiduciary, how far can you go with disclosure?

2. Marketing and Fund Raising
   • How much can you rely on the sophistication level of institutional investors?

3. Valuation
   • Why care if the values are audited or not used to charge fees?

4. Addressing Criticism About the SEC Exam Process
   • Are examiners focusing on the relevant and highest risk areas?
   • Are examiners adequately trained to critically review alternative asset advisers?
Questions
LUNCH

Return at 1:30 pm
Registered Investment Company Topics

Steven Dittert
Renee Esfandiary
Douglas Scheidt
John Farinacci
Charles McCain
Victor Frye
Registered Investment Company Topics

- Distribution in Guise
- 15c Process/Observations
- Alternative Mutual Funds
- Exchange Traded Products
Distribution in Guise
Registered Investment Company Topics

15c Process/Observations
Registered Investment Company Topics

Alternative Mutual Funds
Alternative Mutual Funds – Strong Asset Growth


Based on Data from Morningstar, Inc. and SEC’s Office of Risk Analysis and Surveillance
Registered Investment Company Topics

Alternative Mutual Funds - Demographics

- Total Alternative Mutual Fund Assets: $259 Billion
- Number of Alternative Mutual Funds: 481
- Number of Fund Complexes/Sponsors with Alternative Mutual Funds: 210

Based on Data from Morningstar, Inc. and SEC’s Office of Risk Analysis and Surveillance
Registered Investment Company Topics

AUM by Alternative Mutual Fund Investment Category (as of 12/31/13)

Based on Data from Morningstar, Inc. and SEC's Office of Risk Analysis and Surveillance
Registered Investment Company Topics

Alternative Mutual Funds – Worlds Collide (to an extent)

Private Fund Managers – New to Registered Mutual Funds

Boards of Directors, CCOs, and Operations – New to Overseeing Alt Strategies and Instruments

Registered Fund Managers – New to Alt Strategies and Instruments
Registered Investment Company Topics

Alternative Mutual Funds – Risks/Considerations

- Leverage
- Liquidity
- Portfolio Management
- Valuation
- Conflicts of Interest
- Operations
- Compliance
- Board Oversight
- Marketing
- Distribution
- Tax Considerations
- Suitability
- Market Oversight
Registered Investment Company Topics

Alternative Mutual Funds – Panel Discussion

National Exam Program
Division of Investment Management
Division of Enforcement – Asset Management Unit
Industry

Questions?
Registered Investment Company Topics

Exchange Traded Products
Questions
Question & Answer Session
(Advisers with More Than 1 Billion in RAUM)
FY 2014
Question & Answer Session

Michael Garrity
Ashish Ward
Mark Dowdell
Igor Rozenblit
John Farinacci
Alpa Patel
Doug Scheidt
BREAK
Valuation Issues

Jeffrey Blockinger
Leo Chan
Jaime Eichen
Matthew O’Toole
Sarah ten Siethoff
Valuation Issues

• Why is valuation so important?
• Basic Legal Framework
  • “Value” and “Fair Value”
• Accounting Framework
• Valuation Techniques and Practices
Valuation Issues

• Difficult to Value Investments
• Role of Persons other than the IA (e.g., Board, Pricing Services)
• Exam Process & Observations
• Enforcement cases

• IM's RIC valuation bibliography - http://www.sec.gov/divisions/investment/icvaluation.htm
Chief Compliance Officer Obligations

Mark Dowdell
Janet Grossnickle
Marshall Sprung
Christophe Marzullo
Judy Werner
Chief Compliance Officer Obligations

• **Introduction**

• **Overview – Applicable Rules**
  1. Rule 206(4)-7 under the Inv. Advisers Act
  2. Rule 38a-1 under the Inv. Company Act

• **Best Practices**
  1. SEC
  2. Industry
Chief Compliance Officer Obligations

• Panel Discussion
  1. Industry Concerns

• Resources (Provided as Handouts)
  1. 2009 CCO Outreach Seminar Document
  2. Press Release AMU Compliance Initiative
  3. Compliance Cases

• Enforcement-AMU
Chief Compliance Officer Obligations

Enforcement

- AMU’s Compliance Initiative
  - In re OMNI Investment Advisors
  - SEC v. GEI Financial Services
  - In re Equitas Capital Advisors/In re Gisclair
- In re Northern Lights Compliance Services
- In re Carl D. Johns
Questions
Closing Remarks

Drew Bowden