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PERSPECTIVE

DR. T ON SECURITIES

Preparation is key to a successful SEC fund exam

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Regulation of private fund advisers has significantly increased over time. Examination priorities published by the SEC at the end of 2023 symbolize this increase in scrutiny and regulation will not end anytime soon. One thing was clear from their most recent report, 2024 will see an increase in in-person fieldwork. With more SEC boots on the ground, funds should actively consider the examination priorities and areas of SEC focus and allocate time to preparing for the inevitable: an SEC examination.

The difficulty of any SEC examination is the uncertainty of when it will occur. Most funds can expect to be reviewed every four or five years unless prior exams or certain factors would generate the need for more frequent exams. Because most fund advisers are busy managing their portfolios, improving limited partner relationships and communications and generally just operating their funds, it is difficult to spend time or energy preparing for something that may happen four years into the future. But considering the implications of failing an SEC examination, the time spent to prepare could be instrumental in ensuring the longevity of a fund. The key is to devote time initially to prepare a framework for examination and then dedicate a small amount of time on a quarterly basis to review and execute any necessary updates. While a fund can never fully prepare for the time and effort required when an SEC examination is initiated, establishing a baseline foundation will save time and, most importantly, hopefully avoid any kind of enforcement action.



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Laying the foundation for a successful SEC exam

Funds that are not prepared for an SEC review run the risk of looking disorganized which can lead the SEC to identify issues, conduct lengthier examinations and issue deficiency letters and/or make referrals to enforcement. A culture of compliance is the strongest defense against any dreaded SEC enforcement action, and it begins with a few simple items.

Establish and maintain a document portal

The most time-consuming part of preparing for an SEC examination is just the work involved in compiling the information requested by the SEC. Funds can get ahead

of this by implementing a robust document portal that organizes information into categories and keeping such portal up to date. The SEC will generally send a document request to a Fund outlining documents that fall into the following general categories: 1) Organizational information, 2) business and operations, 3) disclosures and filings with regulators, 4) legal and disciplinary complaints or actions, 5) compliance documents (including policies, procedures, copies of tests performed, guidance and training, etc.), 6) valuation, 7) information and security infrastructure, 8) investor information, 9) marketing and advertising and 10) financial records. To the extent any documents seem to be missing, a Fund adviser should take

the opportunity to ensure the document portal is complete. Once established, key stakeholders in the firm should be delegated the responsibility of keeping the portal updated with new documents, amendments of existing documents, etc.

Conduct internal audits annually

A key strategy in preparing for any SEC exam is conducting a rigorous internal audit to identify and correct deficiencies, especially areas of deficiencies that are SEC examination priorities. The first stage of this is identifying and rectifying gaps in the document portal as it is much easier to review and identify issues if all materials are compiled in one place. Once that is completed, a fund should turn towards identi-

fy key SEC priorities and conducting an internal assessment to identify potential weaknesses or deficiencies and making any necessary corrections. For example, with the SEC's recently amended marketing rule, funds should review their marketing materials for compliance and ensure they have proper substantiation of material facts, adequate presentation of performance information and proper presentation of third-party ratings, testimonials and endorsements.

Once a thorough audit is performed, such an audit process should occur annually to ensure no further updates are required or to ensure that any recent SEC regulations can be implemented as necessary into a fund's infrastructure. Funds can use any identified deficiencies or new or upcoming regulations as opportunities to update and innovate their structures, policies and procedures, as well as continue to educate their teams especially as the firm grows in size and scale. This annual process should be documented and results

from any such audits included in a firm's document portal for future SEC review.

Implement game day preparation techniques

A final step a fund can take in the path to preparation is to implement preparation techniques designed to improve performance during an SEC exam. This would include preparing a presentation, something that is often requested by the SEC and discussed during the first day of the exam review period. This presentation would include information commonly requested by the SEC, including organizational information, client type and assets, service provider relationships, investment processes, including portfolio management and valuation, and compliance program details. This presentation deck can be updated annually in connection with a firm's annual audit to ensure the deck remains current. A firm can also conduct mock interviews with key personnel to prepare all parties for the rigor of an exam and ensure an-

swers are aligned with the firm's compliance regime. Finally, it may be helpful for a firm to do some strategy sessions centered around common SEC questions and areas of focus to ensure that adequate responses are readily available and supporting documentation identified where necessary to further bolster a firm's responsiveness to SEC inquiries.

Preparation is key to success

Preparing for an SEC exam can be a daunting task but doing this early with an eye on continuous updates and improvement will ensure ultimate success. While many of the strategies can be implemented at the time of an SEC exam, the likelihood for error and deficiencies is much higher. Establishing a document portal with all relevant documents, conducting a rigorous and continuous audit to eliminate major deficiencies and ensuring the organizational structure and team are prepared for an exam is the best defense against an SEC enforcement action.

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