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Private Fund Compliance Forum 2018
New York, NY
May 8th – 9th, 2018

Keynote Speaker
David Sorkin, Member and General Counsel, KKR

This year's forum kicked off with David Sorkin and his insights on the evolution of private equity firms and compliance. He noted in the early years/stages, private equity firms had mono-line businesses and that private equity was a generally unregulated area. However, as time went on, private equity firms branched out into multiple types of businesses and broader fundraising approaches, becoming more complex.

Around 2007, private equity recognized how hedge funds were being highly scrutinized and becoming subject to regulations and saw the proverbial writing on the wall. As the SEC began focusing on the private equity industry, compliance started to evolve and become a value-added and highly specialized function of the business. According to Mr. Sorkin, compliance is meant to be a stand-alone function and should be process and procedures driven. He stressed that compliance policies and procedures should be reviewed and updated periodically and that employees should be trained on those policies and procedures. Mr. Sorkin also emphasized that compliance needs to be nimble and be ready to quickly answer questions from regulators.

Mr. Sorkin addressed conflicts of interest, among clients, between a firm and clients, between employees and between a firm and its employees. Firms should identify and document all conflicts and ensure there are policies and procedures in place that address them. Mr. Sorkin highlighted valuation as another significant issue, emphasizing that valuation must be calculated on a consistent basis. Finally, he identified insider trading as a classic area of SEC enforcement.

Mr. Sorkin also addressed cybersecurity and data privacy. Although not traditional compliance competencies, he recognized that both issues have fallen under the charge of compliance for many firms. Mr. Sorkin stressed that in preparing an incident response plan, various areas of a firm's operations should be involved, including legal, IT and public relations in addition to compliance.

Mr. Sorkin recommended that advisors keep established relationships with other advisors to stay current on SEC exam focus areas and to ensure that policies and

procedures are in line with other similar firms and updated accordingly. He also recommended that advisors perform mock SEC exams in order to prepare for the real thing. He concluded by stating that compliance has now become the go-to function by senior management and board of directors.

Restructuring the Compliance Function

Joann Harris, Firm Partner and Chief Compliance Officer, TPG
Bruce Karpati, Member and Global Chief Compliance Officer, KKR & Co.
Scott Weisman, Global Chief Compliance Officer and Senior Regulatory Counsel, Bain Capital

During this session, the panelists agreed that compliance has been elevated within private equity firms and now has a "seat at the table." This change in how compliance is viewed is attributed to the changing regulatory landscape, resulting in the need for CCOs to stay current with regulatory developments and ensure that their firms keep up as well.

Ideas were exchanged amongst the panelists on how the CCO can prevent being "bogged down in the weeds". Some suggested that the compliance responsibilities be divided between the CCO and the compliance team, where the compliance team addresses the day-to-day tasks while the CCO focuses more on those items that affect the long-term goals of the firm, not only from a compliance perspective but from an operations perspective as well. Another suggestion was to identify a firm's resources to be efficient – is the size of the staff appropriate? Are they staying busy? Is outsourcing certain functions such as IT an option?

SEC Exams – What Do they Look Like Now?

Adam Freedman, Chief Compliance Officer, Angelo, Gordon & Co.
Kevin Hiniker, Partner, General Counsel & Chief Compliance Officer, Castlelake
Antoinette C. Lazarus, Chief Compliance Officer, Landmark Partners
John Malfettone, Senior Managing Director, Clayton Dubilier & Rice

Having gone through at least one SEC exam in their respective careers, most of the panelists in this session noted that SEC exams today are shorter, allowing more firms to be examined. The panel also noted that the amount of time allowed for providing documents requested by the SEC staff before the start of their exam or their arrival on-site has been shorter as well, sometimes giving advisors only seven days to gather responsive documents. As one panelist points out, being able to meet the tight deadline demonstrates to the SEC staff that the advisor has good processes in place.

Moving on to a discussion regarding preparations for an imminent SEC exam, the panelists recommended that advisors obtain publicly available SEC document request lists and gather those documents so that they are readily available when they do receive notification from the SEC. It was also suggested that advisors should conduct mock interviews with key firm personnel so they are prepared to speak to the topics that the SEC staff may be focused on. According to the panelists, the SEC staff initially speaks to the CEO, president and CFO of the firm, not only to gather information about the firm but to determine if the officers have a working knowledge of compliance. The panelists also noted that the SEC examination is not just an exam of the advisor, but of the CCO as well, as the SEC wants to determine whether the CCO is effectively embedded in the firm's business.

The panelists further suggested that well before being notified of an SEC exam, advisors should prepare their employees on how to address the SEC staff. A number of thoughts on how to do this were shared. Inform employees to talk to the staff, not down to them. Employees should "stay in their lane," meaning only answer questions relevant to their area of expertise (this also lends itself to establishing substantive credibility). In addition to the employee being interviewed, have someone else from the firm be present to take notes of the interview in the event that later on, if the SEC misstates something that was said, there is supporting documentation of the discussion.

When an advisor does receive notification of an SEC exam, one panelist recommended that a day or two after receiving the document request list, call the SEC staff to get an overview of the exam, to identify any specific focus areas and to have any ambiguous terms and requests clarified. However, when contacting the staff for clarification, one panelist stated that the advisor should have its own interpretation to offer to the SEC and have the staff agree or disagree with that interpretation because at times the staff may not be sure of what they really want to review, particularly for firms with a more unique or complex business model. The panelists did provide this warning: you are never off the record with the SEC, so be mindful of what is said to the staff.

If the SEC has additional requests for documentation, the panelists recommended that advisors get those requests in writing. As for meeting deadlines for gathering documents, of course try to meet the deadlines. However, if more time is needed, let the SEC staff know. As one panelist said, being correct and accurate is more important than meeting a deadline, and the SEC is generally amenable to reasonable requests for additional time.

<u>Assessing Current Regulatory Environment And Navigating Its Impact On Your Compliance Program</u>

Ken C. Joseph, Former Head of the New York Regional Office Investment Management Examination Program, U.S. Securities and Exchange Commission

When asked what has changed since Mary Jo White left the SEC, Mr. Joseph's response was: not much, at least regarding the investigative techniques used by the staff. Mr. Joseph did note that the length of the typical SEC exam today is much shorter on average due to the scope being limited, although an exam could be longer if an examiner finds something worth pursuing. He also noted that anything dealing with retail investors has received higher scrutiny in the last few years. Mr. Joseph continued by saying that fees and expenses and conflicts of interest are always a focus of the SEC during examinations.

Mr. Joseph went on to share some information on how the SEC plans and conducts exams. He stated that the SEC examination agenda is driven in part by budget constraints, meaning that the SEC cannot match the compensation offered by the private sector to attract highly skilled financial professionals. Therefore, the SEC relies on the risk assessments that it performs on advisors to determine how many and which advisors to examine. When on-site at the examinee, the SEC generally wants to talk initially to the portfolio manager(s) and the CCO to see if they have a good understanding of the business and compliance. Depending on the discussions stemming from the responses to those initial questions, the SEC may want to talk to other individuals at the firm. Mr. Joseph did state that SEC examiners are trained on interpreting body language. With that said, SEC examiners may ask additional questions based not only on the substance of the responses, but also on how the responses are presented, something for firms to keep in mind when deciding who to put in front of the examination staff.

Many firms in the financial industry have complained that the SEC does not provide much guidance on the regulations it imposes – and Mr. Joseph agreed. However, Mr. Joseph stated it is the advisor's responsibility to interpret the statutes, laws and regulations and to stay informed. He suggested reviewing SEC published priorities and risk alerts as well as attending conferences as good resources for regulatory guidance.

One area that Mr. Joseph believed will continue to be a focus of the SEC in 2019 is cybersecurity. According to him, advisors must decide when to report a problem (to regulatory agencies) and when to disclose in general. An advisor that does not take corrective actions in the context of cyber breaches is not performing its fiduciary duties, according to Mr. Joseph.

When asked what the SEC can do better, his response was to invest in technology and the training of its staff. Although he acknowledged, again, that the SEC resources will never match those of its examinees. Therefore, the SEC must work smarter.

In conclusion, Mr. Joseph provided the following advice to compliance professionals – stay vigilant. This is not the time to relax. Securities laws are not going anywhere. Understand the risks of the advisor's business. Be aware that today's enforcement climate is to have an individual at the firm held accountable for violations.

Identifying Conflicts At Your Firm

Paul Marnoto, General Counsel and Chief Compliance Officer, Partheon Capital Partners
Kabir Masson, Associate General Counsel and Deputy Chief Compliance Officer, GI Partners
Alpa Patel, Partner, Kirkland & Ellis LLP
Anna Spector, Managing Director and Chief Compliance Officer, CVC Credit Partners

Panelists began this session by sharing conflicts they've addressed at their respective firms. Among those noted were: the reasonableness and fairness of fees charged not only to limited partners but to affiliates as well; co-investors and how they are selected; and transactions between portfolio companies, whether in the same fund or in two different funds, and how and to whom to disclose.

Although the SEC has not included a list of conflicts of interest as part of its examination document request list in recent years, the panelists recommended that advisors maintain one nonetheless. Every conflict should have an explanation on how it is being mitigated, and by documenting this, it will help ensure that the conflict is addressed consistently in the same manner in the future. In the panelists' opinion, this documentation will carry a lot of weight when it's readily available if requested by the SEC during an exam. A lack of a formal structure to address individual conflicts places the burden on the CCO to provide a reason for the treatment of the conflict if questioned by the SEC.

A survey of the conference participants showed that most of them have not been asked for a list of conflicts during an SEC exam. This led into a discussion among the panelists about co-investments and what type of information should be disclosed, specifically with regard to the allocation of fees and expenses. One panelist referenced a 2014 enforcement case in which the advisor did not disclose that costs incurred by the fund would be borne by the fund and not allocated to co-investors. The conclusion made by the panelists was to disclose co-investments and fee arrangements, whether to all limited partners of a fund or to just those interested in co-investment opportunities.