

Streamlined SEC Exams a Relief for Managers

It is becoming increasingly clear to industry lawyers that the SEC is taking a softer approach when it comes to routine examinations of fund managers.

Until last year, the agency's Office of Compliance Inspections and Examinations typically notified fund operators they were being audited via letters that ran to a dozen or more pages and included scores of questions. Now, a more typical exam letter is 4-5 pages covering half as many questions.

SEC examiners also are taking far less time conducting on-site inspections, and are now less nitpicky. "Historically, on-site [inspections] for medium and large funds, and even some small firms, ran over 20 days," said **Greg Florio**, founding partner of hedge fund law firm **Florio Leahy** of New York and its compliance-consulting affiliate, **Orical**. "Now, we are seeing a 2-15 day range, with a majority of small and medium-size firms having an on-site of five days or less."

"No two exams are exactly alike," Florio added, "but there definitely is a noticeable change in approach."

Sources are attributing the shift not so much to last year's election of **President Trump**, who has promised to ease the regulatory burden on the financial sector, but to years of criticism that the SEC's National Examination Program was conducting too few audits each year. In response, the SEC began streamlining its examination process for some investment advisors starting as early as 2016. But only recently have industry lawyers concluded that the examination program has fundamentally changed — in a way that is far less burdensome for fund operators.

"The [SEC] staff does seem less interested in just checking a lot of boxes and more interested in a few key areas," said **Marc Elovitz**, a hedge fund lawyer at **Schulte Roth** in New York.

Consider an "examination information request list" the SEC sent to a mid-size fund operator in 2011. In addition to details about the fund's investment process and marketing materials, the SEC asked for a list of all committees and the members of each committee; procedures for monitoring remote offices and contractors; monthly returns for all funds and accounts, as well as their benchmarks; and a budget of all

"soft dollar" benefits the fund received. An examination letter a similar-size fund manager received last year demanded far less information.

The number of hedge fund firms subject to SEC examination increased dramatically in 2012, after the Dodd-Frank Act mandated SEC registration for private-fund operators with more than \$150 million of gross assets. The SEC responded by hiring more examiners, and former **Chairman Mary Jo White** even floated the idea of using outside contractors to supplement the agency's staff. The current chairman, Trump appointee **Jay Clayton**, has rejected the idea of using outside contractors, but still wants to increase the volume of annual examinations by 5% this year.

Data the SEC released in July 2017 showed the Office of Compliance Inspections and Examinations, headed by **Peter Driscoll**, was examining about 13% of investment advisors annually, including both alternative-investment shops and traditional asset managers. That was up from 10% the previous year. Driscoll was named director of the unit last October, after serving as acting director since January 2017.

"Without a doubt, there is an uptick in routine SEC examinations of private fund managers," Florio said. "We are also finding that the SEC staff, specifically the New York and Boston offices, are much more efficient and reasonable in both the way they conduct such exams and the deficiencies they cite."

In the past 18 months, Florio's firm has helped 12 hedge fund clients with exams, out of a total client base of about 100 fund managers. Well less than half of those exams resulted in "deficiency comments" requiring remediation. In most cases, Florio said, the fund managers received "non-material findings" letters, which don't require action.

Contrast that to the situation prior to 2016, when every one of the exams Florio assisted with resulted in deficiency comments, no matter how trivial or technical the issue, he said.

"The largest of fund managers may still get longer exams," Florio said, "but the medium-to-small shops are getting shorter ones than they used to, which makes a ton of sense because their businesses are generally simpler and easier to review." ❖