Paul | Weiss

CLIENT MEMORANDUM

OCTOBER 24, 2023

2024 SEC Division of Examinations Priorities: Takeaways for Private Fund Advisers

Executive Summary

On October 16, 2023, the Securities and Exchange Commission's (the "Commission") Division of Examinations (the "Division") announced its examination priorities for 2024 (available here). Historically, the Division has released the annual examination priorities in the first quarter of each calendar year. But this year, for the first time, the Division staff decided to align publication with the Commission's fiscal year. Acknowledging the shorter eight-month time span from the publication of the 2023 examination priorities, the Division noted that several initiatives and focus areas from last year remain as fiscal year 2024 priorities.

The 2024 priorities reflect the Commission's continued focus on private fund advisers and an increased scrutiny on issues that are relevant for many private fund advisers, including: the marketing rule, valuation of illiquid assets, controls to protect material non public information, the use of third-party and affiliated service providers, adherence to contractual provisions regarding limited partnership advisory committees, fees and expenses, due diligence on prospective portfolio companies, the custody rule and policies and procedures for reporting on revised Form PF. Accordingly, advisers to private funds may wish to pay particular attention to their business practices and policies and procedures related to these risk areas.

Below are more detailed summaries of the Division's priorities particularly relevant to private fund advisers.

Issues Specific to Private Fund Advisers

The Division highlighted the following focus areas for private fund advisers:

- risks present when there is exposure to recent market volatility and higher interest rates, including private funds experiencing poor performance, significant withdrawals and valuation issues, and private funds with more leverage and illiquid assets;
- adherence to contractual requirements regarding limited partnership advisory committees or similar structures (e.g., advisory boards), including adhering to any contractual notification and consent processes;
- accurate calculation and allocation of fees and expenses (both fund-level and investment-level), including valuation of illiquid assets, calculation of post commitment period management fees, adequacy of disclosures, and potential offsetting of such fees and expenses;
- due diligence practices for consistency with policies, procedures and disclosures, particularly with respect to private equity and venture capital fund assessments of prospective portfolio companies;

- conflicts, controls and disclosures regarding private funds managed side-by-side with registered investment companies;
- conflicts, controls and disclosures regarding the selection and use of third-party and affiliated service providers;
- compliance with the Custody Rule (Advisers Act Rule 206(4)-2), including accurate Form ADV reporting, timely completion of audited financials by a qualified auditor and distribution of audited financial statements; and
- policies and procedures for reporting on Form PF, including upon the occurrence of certain reporting events (i.e., the reporting events adopted earlier this year as part of the Form PF final rule amendments).[1]

Issues for All Advisers

The Division highlighted their perennial focus on advisers' adherence to the fiduciary standard and the strength of their compliance programs. Of the several areas of focus for all advisers that the Division addressed, the following are the most relevant for private fund advisers:

- compliance with the Marketing Rule (Advisers Act Rule 206(4)-1), including whether advisers adopted and implemented appropriate policies and procedures, made marketing-related disclosures on Form ADV, and maintained substantiation of their processes and other required books and records; Marketing Rule reviews will also assess whether any advertisements were misleading and whether advertisements complied with the requirements for performance (including hypothetical and predecessor performance), third-party ratings, substantiation and testimonials and endorsements;
- valuation assessments regarding advisers' recommendations to clients to invest in illiquid or difficult-to-value assets, such as commercial real estate or private placements; and
- controls around material non public information and the use of expert networks.

Information Security and Operational Resiliency

Cybersecurity remains a perennial focus area. The Division will continue to review advisers' practices to prevent interruptions to mission-critical services and to protect investor information, records and assets. The Division will focus on: (1) policies and procedures, internal controls, oversight of third-party vendors, governance practices and responses to cyber-related incidents including ransomware attacks; (2) identity theft prevention programs, including whether advisers adequately train their staff with respect to such programs; (3) practices, policies and procedures to prevent account intrusions and safeguard customer records and information, including personally identifiable information; and (4) oversight of third-party vendors, including adviser visibility into the security and integrity of third-party products and services and whether there has been any unauthorized use of third-party providers.

Crypto Assets and Emerging Financial Technology

The Division will continue to focus on crypto assets and emerging financial technology. The Division will continue to review whether advisers involved with crypto or crypto-related assets: (1) met and followed their standard of care when providing investment advice; (2) routinely reviewed, updated and enhanced their compliance processes, risk disclosure and operational resiliency practices; and (3) whether advisers are complying with the Custody Rule with respect to crypto assets that are funds or securities. The Division remains focused on certain services, including automated investment tools, artificial intelligence, and trading algorithms or platforms, and the risks associated with the use of emerging technologies and alternative sources of data.

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[1] As a reminder, private equity and large hedge fund advisers will be required to make Form PF filings on these reporting events starting December 11, 2023. *See* here for a summary of the reporting events.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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