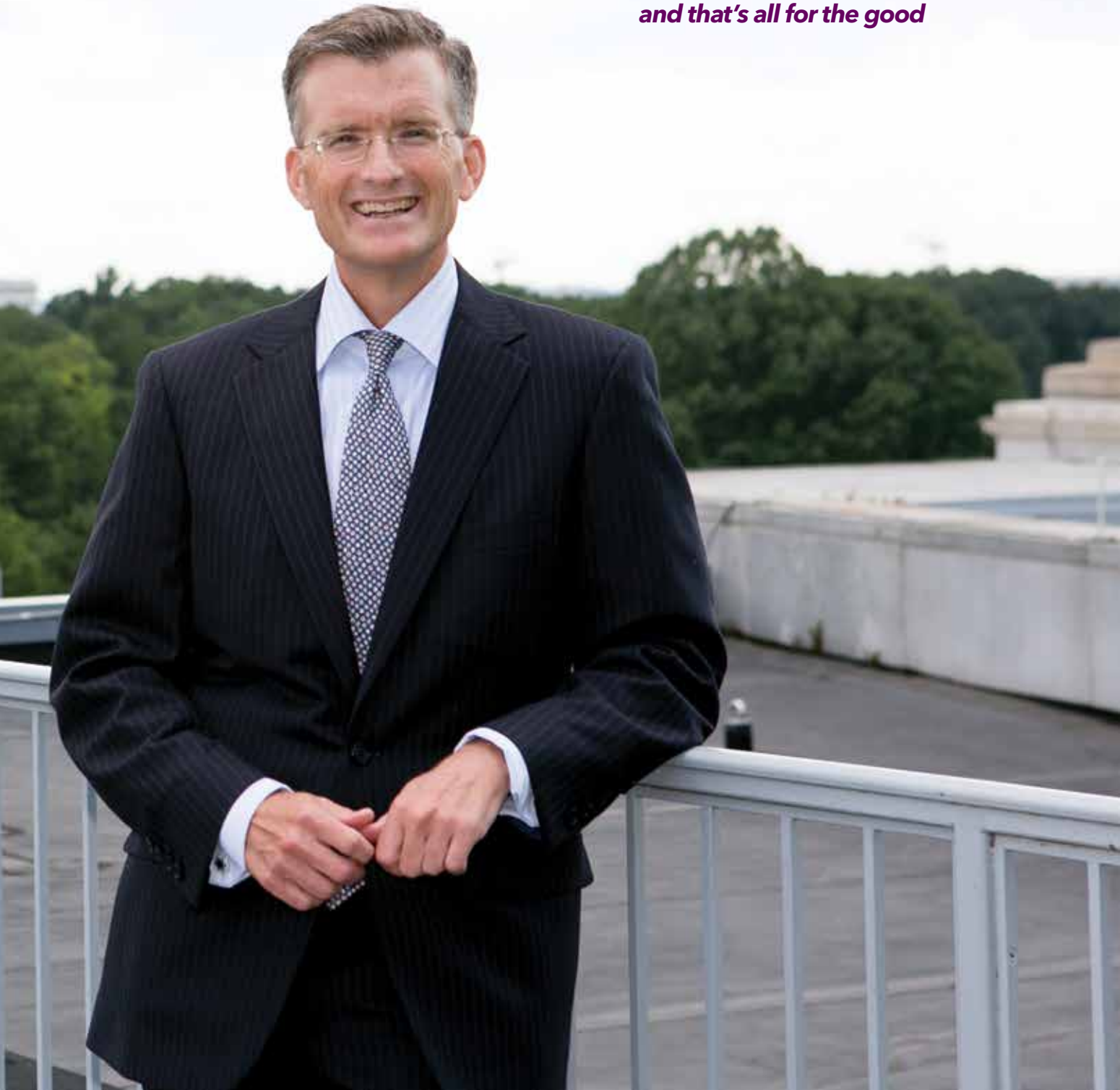


No quarter given

The SEC's Andrew Bowden caused a storm in May with his comments about GP compliance violations. Now, he tells PEI that he doesn't care how much money firms make – as long as they're honest with investors. By [Bailey McCann](#)

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» Not many people have the ability to create a storm by releasing a ‘Sunshine Statement’. But that’s exactly what Andrew Bowden of the US Securities & Exchange Commission did in May at *PEI’s* Private Fund Compliance Forum, with his remarks about what the regulator was finding during its presence exams of private equity managers. Since then, GPs have been hit with angry phone calls and long lists of questions from jumpy LPs.

There was one particular passage that prompted this storm: “By far, the most common observation our examiners have made when examining private equity firms has to do with the adviser’s collection of fees and allocation of expenses,” Bowden said. “When we have examined how fees and expenses are handled by advisers to private equity funds, we have identified what we believe are violations of law or material weaknesses in controls over 50 percent of the time.”

However, in the subsequent months, there hasn’t been much additional commentary from the SEC about exactly what these violations were, who was involved, or what transgressors can expect in terms of enforcement actions. So *Private Equity International* went to Washington D.C to ask the man himself, in his Government office overlooking Capitol Hill.

“I think it’s too soon to tell how the SEC exams will shake out until they’re all done,” he demurs. “Our data in the original

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commentary was based on an initial 150 exams.”

The positive news, though, is that he thinks the industry has raised its game even since the storm broke. “Anecdotally, I would say there have been some changes in the behavior on the part of funds and investors and that’s all for the good. I would tell GPs that want to know what to expect from the examination program to review the letter we sent out in October 2012. That had a lot of information in it, as well as reference material attached to the letter. So, my sort of ‘smart aleck’ remark is: that if a registrant is surprised by our examination process or the questions we ask then they haven’t been paying attention.”

THE BIG STICK

Bowden is in his third year at the SEC. Prior to joining the regulator, he worked at Maryland-based Legg Mason providing counsel, compliance, and sales services and before that, he served as a financial lawyer working with a variety of clients in the financial services industry. When asked if he’ll now be a lifer at the SEC, he says he’s not sure – although he admits the job does offer “fascinating and worthwhile” work. It’s also gifted him a large PEZ dispenser collection, donated by people who visit his office, which he keeps filled with candy for when kids tag along. A bronze of Teddy Roosevelt on the same set of bookshelves perhaps serves to remind visitors that while the SEC may speak softly, it carries a big stick.

The presence exam is part and parcel of the move to bring GPs under the aegis of the SEC, as laid out in the Dodd-Frank act. Since the rules were implemented, GPs have had to register and start filing regular investment position data. As part of that process, the SEC runs them through the same sort of check-up used in other parts of the financial markets. The letter sent out

at the start of this process was designed to school GPs in what the SEC would be looking for.

“There should be a couple [of] things you do as a fiduciary handling other people’s money,” Bowden explains. “When we do an exam, we’re looking to see if you’ve fairly and fully described your investment programme, and that are you sticking to it. That’s one of the things we see from time to time: a GP says they’re going to do a programme that is A, B, and C, but they really do D, E and F. The second part is fees and expenses – so we’re also looking to see if that part of the bargain is fully and fairly described to investors. The third part is that a fiduciary’s responsibility is to describe to clients where there is a conflict of interest. So we’re looking for people to fully describe those conflicts and what they are doing to mitigate them if they exist. I think if you focus on those, you’ll probably stay pretty busy and make it through the process.”

Some lawyers for GPs have noted that a lot of what the SEC seems to take issue with was asked and answered in the LPA negotiation; imposing sanctions now negates part of that contract process. One told *PEI* in July: “They are asking one of my clients to pay back tens of millions of dollars, despite there being a partnership agreement in place that allowed for the charges, and despite enhanced disclosure having been made.”

Bowden says that whether the SEC recommends repayment, an enforcement action, or other form of settlement is all a matter of degree. “If our examiners come in and see something on the margin that’s a coin toss, we’re very unlikely to escalate that beyond the examination program.”

“On the other hand we may have a problem if for example, we go in and we see an expense assessed to, or a fee collected from a fund or a portfolio company that is not clearly disclosed, and the magnitude of »



» the expense is significant in relation to the carried interest or the management fee. Then we have to ask ‘has the fiduciary met its duty to make full and fair disclosure so that the investor really understands?’”

This is not about the SEC going after GPs because the regulator thinks they’re making too much money, Bowden says. Instead, it’s about ensuring that the fiduciary responsibility for handling other people’s money is met.

Will there be more enforcement action? “I think as a mathematical answer the answer is yes, because more people are now registered. But I also think most people are doing the right thing,” he says.

ON THE UP AND UP

What does the SEC think a perfectly managed fund should look like in this new world? Pretty close to what they look like now, actually.

“I don’t think we have a view of what a perfect fund looks like. Broadly speaking, private equity has a great business model. Over the last 20 years or so the returns are strong on an absolute basis and relative to most other asset classes. So when you sit back and think about all of the people in the world who are engaged in money management private equity has added a huge amount of value. On the whole, they’ve delivered for their clients. Because of that and the business model they’re also doing well for themselves.”

“People think that after the speech that we looked at private equity firms and thought they make too much money. That’s not it at all. I am fascinated by the people who are doing well for their clients and themselves, they have a great business, but they will risk losing the trust of their clients or getting crossways with us.”

The absolute level of fees is not its concern, he insists. “If you have an investment program and you can deliver to the client,





as long as you're fairly and fully describing what it is they're going to pay for those services, we have no problem if its 2/20, 2/30, 3/30 – as long as it's clear up front.”

Still, that may not be enough for all of the SEC's critics. Bowden notes that while a lot of people thought the Sunshine Statement took an aggressive stance towards GPs, others claimed it didn't go far enough. Some have said that the Mary Jo White SEC era has been marked more by a general sluggishness; that it's been more concerned by turf wars with the Financial Stability Oversight Council than enforcement. Not surprisingly, Bowden disagrees.

“Our examiners come to work every day with the understanding that they're serving investors, our capital markets, and also America. We need markets that people can trust. You want things to be fair and on the up and up. We're working hard. People will take their shots and say

we're not doing enough or doing the right things. We're in the arena trying to get things done and you have to take the hits that come with that.”

The exams are a way for the SEC to get things done – as is the newly-formed private funds group, which puts industry experts in a room with examiners. The US is then broken up by region and each expert team works through the process. According to Bowden, the SEC adopted this model to ensure that the exam questions are relevant and appropriately focused for private equity, which is of course a new asset class for the regulator itself.

But even with that targeted approach, budgets still constrain how much the SEC can realistically do. “I think when you look at what the examiners have been able to accomplish so far, they're doing a great job,” Bowden says. “But when you look at it from a budget or policy level, the American

people have to decide how much they want to turn the dial on regulation. Right now, we're conducting examinations of about 9 percent of all registered advisors on an annual basis. If you tell people that are they really going to think that the system is well regulated at 9 percent? I don't think so. But, that's a policy decision. We still have to come in each day, do the examinations and keep at it.”

So what's the headline takeaway for GPs and LPs about how the SEC is handling this process? “I think people have to understand that if they're doing everything fairly, and clearly, and it's on the up and up, we're probably ok,” says Bowden. “But if you're cross the line and breach your duty or lie outright, we will give you no quarter – and we are looking. There is a responsibility attached to handling other people's money, and firms have to remember that.” ■