

Nov. 14, 2024

Chief Compliance Officers

Tips for Creating an EOY Compliance Checklist (Part Two of Two)

By Jonathan Shazar, *Private Equity Law Report*

To adequately perform their role, a CCO needs to remain steadfastly focused on compliance issues and risks faced by their firm throughout the year. It is important, however, to differentiate between the daily compliance risks that CCOs need to monitor and the broader, more holistic ones that also require attention. Whether it is related to, among others, managing employment arrangements or service providers, the year-end (EOY) is an excellent time for CCOs to use EOY compliance checklists to ensure those matters do not slip through the proverbial cracks and become a problem in the new year.

This second article in a two-part series offers tips about items to include in an EOY compliance checklist relating to personnel, regulatory developments, third parties and budgets, as well as ways to prepare for the first quarter of the new year. The first article highlighted why it is important for CCOs to use EOY compliance checklists; approaches CCOs can take to compile their checklists and calendars; and some of the documents, policies, procedures and filing requirements to address during an EOY review.

See “[2024 Survey Reveals Top Compliance Concerns and Common Industry Practices](#)” (Sep. 19, 2024).

Performance Reviews and Bonuses

In addition to the many EOY compliance-related tasks they may be juggling, compliance team members have something else in mind as the year draws to a close: bonus season, said Christopher Mendez, senior counsel at Crowell & Moring. Before bonuses can be issued, CCOs have to conduct performance reviews. And before they can do that, they need to “take a step back and look at the entire compliance business unit to consider promotions and responsibilities throughout their respective firms,” he proffered.

Each firm will handle performance reviews and bonuses differently, however, and possibly at different times. Further, the data required to calculate bonuses may not be available until the first quarter of the new year. “Still, year-end is when PE sponsors begin to figure out who is entitled to a share of

management fees, or if any carried interest has been paid during the year,” said Akin partner Ira P. Kustin. “Bonuses and carry-planning is something that takes up a lot of time in the fourth quarter.”

Budgetary Planning

Another area that each adviser will undertake in different ways is creating a budget for the compliance department for the following year. Those conversations about next year’s budget will likely start or continue during the EOY period, and CCOs must be ready for it.

Staffing

As part of the performance review process, a CCO might realize that they are understaffed. Mendez advised reaching out to the CFO in the fourth quarter about budgeting for new hires to fill those needs in the upcoming year.

In addition, EOY is also a time to consider existing third-party relationships and potential new ones. For instance, Mendez suggested that if the budget does not exist for new hires, leverage could be built by relying on more cost-efficient consultants or leaning on outside counsel rather than bringing on a new in-house lawyer.

See [“Advice for Allocating Legal Tasks Between In-House Attorneys, Outside Counsel, Consultants and Other Vendors \(Part Three of Three\)”](#) (Mar. 24, 2020).

Technology

CCOs should spend time in the fourth quarter considering their technology stack, bringing any potential upgrades to their CFO and senior leadership team. Although new technologies can incur a significant cost, CCOs should make sure they present a compelling business case as to how the new systems will create efficiencies or prevent deficiencies going forward.

As part of that process, CCOs should stay abreast of industry developments and regulatory trends to help inform where their technology spending can achieve the maximum effect. For example, with the growing number of SEC enforcement actions targeting off-channel electronic communications, including the first involving private fund advisers, CCOs must begin to consider technological solutions for adequately capturing and retaining data from whichever messaging and collaboration tools the manager uses.

“This is definitely an issue that keeps folks up at night,” Mendez said. “These projects take a lot of conditioning – *e.g.*, to get people to switch to Slack or Microsoft Teams – and then ensuring all of those communications are retained by e-mail capture systems. It is such a complicated project, and not all of the technology works.”

See [“Designing a State-of-the-Art Private Fund Compliance Department: Leveraging Cutting-Edge Technology”](#) (Sep. 21, 2023).

Political Contributions

Rule 206(4)-5 of the Investment Advisers Act of 1940 (Advisers Act) – known as the pay to play rule – comes into focus in major election years. Further, there are elections every year that call into question state and local pay to play rules. Experts interviewed by the Private Equity Law Report agreed, however, that presidential election years tend to concentrate CCOs' minds on the issue.

Registered investment advisers are barred from providing paid investment advisory services to any state or local government agencies (e.g., public pension funds) for two years after an adviser or covered person contributes to any candidate for state or local office – regardless of their success in that campaign. Violations can be expensive, as evidenced by **Wayzata Investment Partners** being fined \$60,000 for a covered associates' \$4,000 contribution in an SEC enforcement action brought in April 2024. Further, regulators may also seek the forfeiture of any fees collected by the advisers during the two-year window.

With 11 gubernatorial elections in 2024, including in states where public pension funds are particularly active in the PE space, it is critical that CCOs emphasize the importance of senior executives and other covered persons pre-clearing all political donations, including donations made through political action committees (PACs) such as ActBlue and WinRed. “A lot of employees think that PACs are faceless and nameless,” said Ross Goffi, CCO at PE manager ParkerGale Capital and founder of compliance consultancy Trillium Regulatory Services. “Unless you earmark how your donation is allocated at the outset, it is possible that the PACs will allocate a certain amount of the donation to a campaign that could result in a violation of the pay to play rules.”

Although donating to federal campaigns generally does not trigger pay to play rules, it may if the candidate for federal office currently holds a relevant state or local office. To that end, several recent presidential elections have featured sitting governors as vice presidential nominees – most notably, when then-Minnesota Governor Tim Walz ran on the Democratic ticket. Walz's presence in the U.S. presidential campaign created a concern for advisers with mandates or allocations from Minnesota state pension plans.

See “**Key Pay to Play Issues for Fund Managers During an Election Year**” (Sep. 5, 2024).

Service Providers

Review Third-Party Relationships

In addition to being a time to lean on outside counsel and compliance consultancies, Mendez said that the EOY is an important time to consider how best to use those service providers and others – as well as whether to continue using them at all. “You should add termination notice periods to your EOY compliance checklist and internal calendar,” he urged. Otherwise, an automatic renewal may lock you into an unwanted relationship for another year.

If a CCO does plan to bring on a new service provider, they should use the fourth quarter to consider the implications and timeline. Searching for, hiring and integrating a new consultant or other

vendor requires significant time and effort, which should be reflected on the EOY compliance checklist.

Consult With Outside Counsel

During his time as a CCO, Mendez would check in with consultants and outside counsel during the EOY period. In addition to considering the year's events and regulatory developments, and setting priorities for next year, he recommended speaking with outside counsel about their work with others at the firm over the course of the year ending. "At large PE firms, it is not uncommon for deal teams to interact directly with outside counsel, and you might not be in all of those conversations," he said. "This would be a good time to put time on the calendar with your outside counsel to gauge what has come up in those conversations, and whether there's anything you should be thinking about in connection with them."

Further, CCOs should also take time during the fourth quarter to consult with their legal specialists on specific issues. "Talk to your tax advisers and lawyers to ensure that anything that needs to happen before year-end happens in the right way," Kustin counseled. "Year-end is also a good time for any adviser to take stock of what they need to be doing from an employment perspective: matters of local law; city or state requirements; notice requirements; etc. That is something an adviser is going to want to work on with employment counsel."

See "[Best Practices for Fund Managers to Mitigate Litigation and Regulatory Risk Before Terminating Employees](#)" (Feb. 9, 2017).

Obtain Outside Assistance

While preparing and going through their EOY compliance checklist, CCOs may come across items that were neglected that now require immediate, short-term attention. Those may require additional help that compliance consultants, outside counsel and other vendors can provide.

"That is obviously a time when your compliance team is going to be stressed," said Jacqueline Hummel, director of thought leadership at SEC Compliance Consultants. "It may be time to have an outside party complete the annual compliance review, just to get a fresh look."

That approach may be especially important for smaller advisers, Goffi added. "CCOs without a dedicated compliance resource are often performing other jobs, putting out fires and dealing with day-to-day responsibilities, which causes compliance matters to become an afterthought. When they finally get to it, it has snowballed to a point where it might not be manageable anymore."

Monitor Regulatory Concerns

CCOs must keep abreast of new laws, rules and regulations – as well as what regulators are focused on in examinations and from an enforcement perspective – to ensure their firms are adequately addressing those particular areas of focus. Mendez and Goffi recommended leaning on outside counsel and compliance consultants to avoid having something fall through the cracks. To that end, the

following are some areas that CCOs should target in their EOY compliance checklist in light of recent regulatory developments and attention from the SEC.

Marketing Rule

The SEC is particularly concerned about verifying that a fund manager's marketing materials and practices comply with [Rule 206\(4\)-1](#) under the Advisers Act, known as the Marketing Rule. In 2024, the agency has brought a number of enforcement actions related to the rule, and also issued a new risk alert. "You want to take the opportunity at year-end to go back and ensure your performance numbers match in a way that complies with the Marketing Rule," Mendez suggested. "Do we have good quality assurance? Do we have the records to back up the performance claims?"

To that end, if an adviser is preparing to begin raising a new fund early in the new year, it is imperative that a CCO spend time in the fourth quarter reviewing and updating its marketing materials, a process that also helps ensure compliance with the Marketing Rule. "This is a great year-end checklist item – looking at all of your firm's marketing materials and thinking about appropriate updates," Mendez said.

See "[Recent SEC Enforcement Sweep and Risk Alert Highlight Weak Areas of Marketing Rule Compliance for Managers to Bolster](#)" (Jun. 13, 2024).

Electronic Communications

In 2022, the SEC signaled that it would extend its investigation into off-channel communication violations to the PE industry, with requests for information sent to a number of large advisers. The first settlement with a PE sponsor came in April 2024, and published reports indicate that several major players may be negotiating settlements of their own with the SEC. It is clear that the agency remains focused on electronic communications, and that it has little difficulty finding alleged violations during examinations.

As a result of that SEC scrutiny, CCOs should use their EOY compliance checklist as an opportunity to apprise themselves of best practices in the industry to discern if they need to integrate any updates into their compliance practices. Along that vein, CCOs should also verify their existing practices match the requirements in their policies and procedures.

Custody Rule

In recent years, there have been more than a dozen enforcement actions related to violations of Rule 206(4)-2 of the Advisers Act, known as the Custody Rule, which requires advisers to undergo a surprise annual custody examination. "Firms can violate the Custody Rule by not doing anything," Goffi warned. Luckily, "it is pretty easy to do," he added. Therefore, it may make sense for CCOs to vet their custody practices as part of their EOY compliance checklist.

See "[SEC Settles Five Additional Enforcement Proceedings for Custody Rule and Form ADV Violations](#)" (May 2, 2024).

Prepare for the First 120 Days

Although the last three months of the year can be a busy time, the first three or four months of the new year are, if anything, even busier. Fund managers are responsible for preparing their Form ADV, Form PF, and other required filings and disclosures, along with preparing for annual trainings, completing ongoing SEC examination preparedness and testing their compliance program. Amidst that chaos, Goffi advised avoiding “trying to prepare and do at the same time.” That means, CCOs should use the EOY and their compliance checklist to put together a plan for the new year and attempt to get a head start on upcoming tasks.

Update Annual Filings and Deliverables

Perhaps the first thing that CCOs must complete in a new year is their annual code of ethics report, which is due at the end of January. That means it is important to send notice to employees before they leave for the holidays, Hummel suggested.

Beyond that, fund managers often find that preparing their “Form ADV is a big lift at the end of first quarter of a new year, followed quickly thereafter by Form PF and ancillary reports,” Mendez said. To make that process as smooth as possible, he suggested “ensuring that you’re getting teed up for the annual update cycle” in the fourth quarter. Both he and Goffi recommended testing throughout the year - including in the fourth quarter - to ease the burden of the annual review.

Similarly, Kustin urged CCOs to “at least start thinking about the Form ADV process and who will need to be involved before year-end,” and notify them in advance to give them as much time as possible to prepare for their roles. CCOs should also consider whether their manager is large enough to require quarterly Form PF filings, rather than the annual one due at the end of April, Goffi added.

See our two-part series: [“Key Provisions for PE Sponsors in the Final Amendments to Form PF and Relevant Departures From the Proposal”](#) (Jun. 29, 2023); and [“Overarching Takeaways From the Final Form PF Amendments and Suggestions for How PE Sponsors Can Prepare to Comply”](#) (Jul. 13, 2023).

In addition, the first quarter is the time for preparing audited financial statements for an adviser’s funds. It is advisable that a fund manager begin that process in the fourth quarter if they haven’t already - and especially if “they use the annual audits as your method for complying with the Custody Rule,” Kustin emphasized. CCOs should also prepare their Schedule K-1 tax documentation as far in advance as possible.

Prepare for SEC Examinations

“Exam preparedness is a lot of work,” Mendez warned. “We map out the scope in the fourth quarter - that’s on our compliance checklist - and then we kick it off in the first quarter of the new year,” he explained. “That process includes incorporating various components of the SEC exam preparedness project throughout the year, and building the findings into the annual compliance review performed under Section 206(4)-7 of the Advisers Act.” That is especially important for emerging managers who have yet to be the subject of an SEC examination, he added.

See our two-part series: “[What to Expect During an SEC Examination and How to Prepare](#)” (May 30, 2024); and “[Trends in Topics Targeted During Recent SEC Examinations of PE Sponsors](#)” (Jun. 13, 2024).

Along that vein, EOY is also a perfect time to check in with colleagues to see if their year-end reporting responsibilities have been completed – and if so, to request copies of the reports, Hummel suggested. Otherwise, when the SEC shows up, the CCO may be left scrambling because “service provider contracts are in 16 different places, and nobody knows where they are.”

See “[SEC Risk Alert and Accompanying Checklist Explains Examinations Process and Identifies Key Documents to Have Ready](#)” (Nov. 2, 2023).

Plan Compliance Training

According to Mendez, it is often preferable to conduct compliance training at the beginning of the year. “With everybody back from the holidays, you can typically get all hands in on training in the first quarter,” he reasoned. “It’s also a good time to condition folks for Form ADV and the importance of correct regulatory filings.” That, however, requires reviewing and updating your training programs in the fourth quarter.

“Make it part of your process,” Hummel urged. “As you go through your compliance program and document your annual compliance review, you may have things you want to talk about with the firm’s employees. It is a good opportunity to have a short training on any changes made.”

See our two-part series on compliance training: “[SEC Expectations and Substantive Traps to Avoid](#)” (Mar. 15, 2022); and “[Who Conducts the Training and Five Traps to Avoid When Providing Training](#)” (Mar. 22, 2022).

Conclusion

Building a comprehensive EOY compliance checklist, along with an updated compliance calendar, is perhaps the best holiday gift a CCO can give themselves – and their firm. “I’ve used an EOY compliance checklist to get ahead of regulatory issues and to implement necessary updates and changes,” Mendez recounted. “Because of that, the SEC did not go down a rabbit hole and instead focused on areas where we were in compliance, and I saved us a multi-million-dollar SEC enforcement action simply by being a disciplined CCO.”

“Use the EOY to prepare so when January rolls around and everybody comes back, you at least have a plan in place to execute as opposed to starting the plan,” Goffi advised. “Get all of those things in place now and hit the ground running come January 1st.”