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Chief Compliance Officers

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

By Jonathan Shazar, *Private Equity Law Report*

The first and last quarters of any year are among the busiest of a CCO's calendar, as well as those of their respective colleagues. The sheer number of reports, filings, disclosures, deadlines, reviews and other tasks to be completed increases the probability of something falling through the cracks, which ultimately might be revealed at great cost during an SEC examination. The rigors of that six-to-seven-month stretch can be eased by proper planning. As CCOs enter the year-end period (EOY), they would be well-served to have a plan for what must get done and when.

This two-part series offers a roadmap of tasks that CCOs can use to develop their own EOY compliance checklist. This first article highlights 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. The second article will offer 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.

See our two-part series "A Checklist for Investment Advisers to Streamline and Organize Their Annual Compliance Program Reviews": Part One (May 12, 2020); and Part Two (May 26, 2020).

Value of an EOY Compliance Checklist

The fourth quarter of the year and the first quarter of the next year are perhaps the busiest times for CCOs and their firms as a whole. "Year-end often results in a time crunch because there is a list of things the CCO just didn't have time to get around to until they were forced to," said Akin partner Ira P. Kustin. Worse, however, is if those things are not done at all. "In such a fast-paced, fast-moving environment, so many things are overlooked," added Christopher Mendez, senior counsel at Crowell & Moring. "Those items ultimately become the subject of deficiency letters and SEC enforcement actions because CCOs never spent the time even thinking about a checklist or compliance calendar."

Creating compliance checklists and calendars is especially important for CCOs that are dual-hatted (*i.e.*, also serve as CFO or in another capacity at a firm), as is the case at many middle-market PE firms. "Compliance work usually finds its way to the outskirts of their desks because they are better at the finance role," reasoned Ross Goffi, CCO at ParkerGale Capital and founder of compliance consultancy firm Trillium Regulatory Services. Therefore, checklists and calendars help them "stay on top of this stuff." Such preparatory work, if it has not been previously done, should be tackled in the fourth quarter to avoid similar issues in the following year.

Creating the EOY Compliance Checklist

An EOY compliance checklist will look different for every firm and CCO depending on their strategies, investor base and compliance capabilities. There are, however, some fundamental steps that each CCO can take to identify the types of items that need to be addressed in their EOY compliance checklist.

Mandatory Compliance Reporting and Testing Obligations

Near the top of any checklist should be an enumeration of compliance reporting obligations, Mendez said. "At a minimum you should ensure that your quarterly reporting gets done on the compliance program. That tees you up for the annual update cycle coming in the first quarter," he explained. Equally important is confirming that required annual testing has taken place, according to Jacqueline Hummel, director of thought leadership at SEC Compliance Consultants.

See "Testing Is an Integral Component of Compliance Programs" (Jul. 25, 2024).

Ongoing Issues, Changes and Developments

When he served as GC and CCO at two private fund managers, Mendez would not wait for an EOY compliance review to begin considering changes. Instead, he kept a rolling document noting matters that came up in conversations with colleagues and third parties, or as issues arose during the year. Unique investment allocation decisions, complex trades and new jurisdictions served are the types of things he recorded to resolve by EOY or to add to plans for the next year.

"That process of maintaining a rolling list of issues really informed how I thought about updating our compliance program documents," Mendez said. "I might memo-to-file certain things that I wanted to address later in my compliance policies and procedures. I would think about all of that in the fourth quarter."

Previous Compliance Deficiencies

CCOs should analyze their adviser's most recent annual compliance review to confirm that any deficiencies identified have been addressed, or that there is a plan to do so in the new year, Hummel urged. “You often see people breathe a huge sigh of relief once their annual compliance review is done,” she explained. “The problem, however, is that they often fail to go back to follow up on the findings therein. The SEC hates that kind of thing.”

It is also important to consult the minutes or notes from quarterly compliance and risk committee meetings, Mendez said. “What did we talk about? What did we debate throughout the year in these various committees? Is there anything we want to add to next year’s agenda?”

Further, EOY is a good time for a CCO to review their firm’s risk assessments. It is important to consider whether an adviser’s risk profile has changed, and what those changes require. “Theoretically, you should be looking at your risk assessment periodically throughout the year, but I have never met a firm that had,” Hummel noted.

See “Improving Compliance Programs With Gap Analysis and Risk Assessments” (Dec. 14, 2023).

Legal and Regulatory Changes

CCOs must keep abreast of both legal and regulatory developments, as well as regulators’ areas of focus, when updating compliance checklists, calendars and manuals. Luckily, there are many resources available, including free materials published by law firms and compliance consultancies. Compliance consultants and outside counsel can also be leveraged in this area.

“There are always new rules that need to be added to compliance calendars and monitored for compliance,” Goffi said. For example, he noted that the Financial Crimes Enforcement Network’s anti-money laundering rules come into effect at the beginning of 2026 and must be addressed next year. “Let’s start to get it in there now as we are doing the edits for this year or early next year.”

Fund- and Manager-Level Changes

Another broad category of items to address in an EOY compliance checklist are changes at the fund manager – at an operational level (*e.g.*, new personnel or offices) and the fund level (*e.g.*, new investors, strategies, etc.) – that need to be scrutinized and addressed in updates to the firm’s policies and procedures, as well as its future filings. “Figuring out what’s new is a good place to start to make sure that your policies and procedures address all of those things adequately,” Kustin asserted.

To start, CCOs at advisers should consider if there have been any material changes to the makeup of their funds’ investor bases. For example, under the Employee Retirement Income Security Act of 1974 (ERISA), if any employee benefit plans account for 25 percent or more of any class of equity of a fund, then that fund is subject to ERISA fiduciary duties, including additional filings and fidelity bonding. Hummel advised CCOs to consider whether redemptions and new allocations may have put a fund over or under that threshold so they can ensure that appropriate bonding is in place if necessary.

See “How DOL’s Changes to the QPAM Exemption and the New ERISA Retirement Security Rule Impact Fund Managers” (Jun. 27, 2024).

In addition, changes to the structure and composition of the fund manager itself can result in EOY obligations that the CCO needs to be able to verify, Hummel stated. For example, private funds have become major acquirers of registered investment advisers in recent years, but such deals need to be structured appropriately to comply with Section 12(d) of the Investment Advisers Act of 1940 (Advisers Act). “That is something you want to make sure you do by year-end,” she said.

Types of Reviews to Conduct

Existing Documents

There are a number of documents that CCOs should plan to review during the fourth quarter of each year for updates and changes, as well as to ensure they accurately reflect their firm’s actual practices. That list includes the following items identified by experts interviewed by the Private Equity Law Report, as well as the compliance calendar used by CCOs to prepare filings for the next calendar year.

Whenever changes or errors are unearthed during this document review process, it is crucial to fix them in a timely manner, Hummel advised. “Even if it’s done later, it’s much better than to never correct the issues at all and hope the SEC is not going to find them during an examination.”

Offering Documents and Marketing Materials

The pace at which private fund managers, especially larger advisers, raise new funds has quickened dramatically, with new funds going to market every year. Meanwhile, the SEC’s focus on the Marketing Rule – it issued a new FAQ on February 6, 2024, on the presentation of internal rates of return and remains active in bringing enforcement actions for violations – has not abated. As such, reviewing marketing and offering documents should be at the top of a CCO’s EOY checklist.

“That is the first thing that comes to mind,” Kustin said. “Make sure that your offering documents are up to date.” For one, he noted that private placement memoranda are often no longer static documents retired once a fund holds its final closing. “More PE sponsors are using evergreen structures – or something that approximates an evergreen structure – which means their offering documents are going to be live documents that are used for a much longer period of time.”

All factual statements in offering documents should be periodically reviewed, ensuring that their accuracy can be documented and verified in the case of an SEC examination. In addition, they should be reviewed for any deviations in practice over the previous calendar year.

See “Marketing Rule FAQ Clarifies SEC Expectations for Calculating Net and Gross IRR When Using Subscription Credit Facilities” (Apr. 4, 2024).

Organizational Charts and Related Documents

Employees come and go, and their responsibilities change over time. In the fourth quarter, CCOs should consider reviewing whether a manager's organizational chart reflects those changes. "The SEC is going to ask to see that if they do come in, and oftentimes nobody's really looking at it internally before that request is made," Hummel said.

Another set of documents that may have individuals and roles specified, and that may not be as assiduously monitored as they could be, are business continuity and disaster recovery plans, Hummel added. "You want to ensure all the plans and information in those documents remain correct, and to update them if people accounted for therein have since left the firm."

Finally, CCOs should review their firms' insurance policies to discern whether any amendments or adjustments are needed to the firms' insurance coverage, including their cyber insurance and director and employee insurance. "The year-end period is an appropriate time to consider whether the firm is appropriately insured given any changes that have arisen over the past year," Kustin suggested.

Policies and Procedures

CCOs are not the only ones carefully reviewing a manager's policies and procedures. SEC examiners are as well, and it is common for that to result in violations of Section 206(4)-7 under the Advisers Act, Hummel explained. "I would print out some of those policies and walk them over to the departments they apply to and say, 'This is what we say we are doing. Is this actually how we are doing it?'"

The following are some of the items covered by a firm's policies and procedures that should be reviewed as part of a CCO's EOY process.

Annual Compliance Review

Rule 206(4)-7 under the Advisers Act generally requires registered fund managers and other registered investment advisers to evaluate, at least annually, the adequacy of their compliance policies and procedures and the effectiveness of their implementation. Therefore, it is imperative for fund managers to thoughtfully consider how to approach the annual compliance review process with the goal of mitigating weaknesses in their compliance programs.

As part of that process, CCOs should also review their firm's most recent annual compliance review, both to ensure that any deficiencies or discrepancies uncovered have been corrected, and as a baseline to consider what material changes in a firm's operations, organization and practices may need to be addressed, Kustin advised. "Are there new funds that have been launched? Has the adviser brought a new team on board with the new strategy? Are they operating in new jurisdictions? Do they have new classes of investors that they didn't have to deal with before?"

See our two-part series "How Fund Managers Should Approach Preparing for, Conducting and Documenting the Annual Compliance Review": Part One (Aug. 2, 2022); and Part Two (Aug. 16, 2022).

Compliance Manual

A valuable step is for CCOs to review the rules laid out in their firm's compliance manual to "make sure you are covering everything you are supposed to be, that it reflects any changes in the law and addresses any updates to your business, operations or practices," Hummel recommended. That review should also include monthly or quarterly tasks, such as ensuring that any committee meetings – *e.g.*, compliance, risk, valuation and others – took place and were properly memorialized.

The compliance manual gap analysis is a "whole-firm activity," Hummel emphasized. Even if the analysis and subsequent update is not completed during the fourth quarter, it is important to begin the process before deadlines begin to pile up in the new year.

Accounting Practices

Likewise, the SEC expects a manager's practices around fees and expenses to be clearly delineated and adhered to. Both Hummel and Kustin recommended an EOY review of a firm's expense allocation practices to ensure that only those specifically permitted to be charged to investors were, while others were borne by the funds themselves.

Similarly, Hummel suggested an EOY review of any distributions and redemptions paid out to clients during the year to ensure compliance with the process established by funds' offering documents.

Conflicts of Interest

EOY is also an appropriate time to review potential conflicts of interest, especially those that may have arisen through new business relationships. "The SEC always seems to find some new ones," Hummel said. "What kind of businesses are your executives involved with outside your firm? Are there any relatives in the business? Those are things you should be checking on an annual basis."

The last quarter is also a good time to gather holdings reports from access persons as required by Rule 204A-1 under the Advisers Act, or to confirm that they have been collected throughout the year, Kustin added. "Review those to make sure there is evidence of review and signing off on them," Goffi suggested. "Make sure they are all in on time."

Filing, Disclosure and Reporting Requirements

A private fund manager's compliance calendar will be full of various deadlines for regulatory filings and investor disclosures. Before one year's calendar turns to the next, CCOs should check that all of the filings took place. To that end, Goffi recommended that CCOs build a spreadsheet of all required filings, attestations and certifications that are necessary throughout the year. "Were they sent out on time? Were they reviewed? Are they complete?"

See "Compliance Program Implementation: Compliance Calendars and Testing" (Sep. 5, 2024).

Section 13 Filings

Changes to disclosure information on Form 13G beneficial ownership filings are due within 45 days of EOY. Given the amount of work required on other filings in the first quarter of the new year, Hummel suggested checking whether such amendments might be required in the fourth quarter. EOY also provides an appropriate time to consider any necessary changes to Form 13H large trader registrations, and to consider whether any Form 13D beneficial ownership reporting obligations need to be addressed.

Although Form 13F equity holdings reports are generally the province of other types of asset managers, CCOs of PE sponsors should consider whether any of their manager's funds have crossed the threshold requiring them for the first time, Kustin advised.

Treasury International Capital Forms

Another type of filing that may be neglected - or even unknown – to most private fund managers is Treasury International Capital (TIC) forms, and similar reporting requirements from the U.S. Bureau of Economic Analysis. "Some apply to all private fund managers, while some only apply to those managers that receive a request from the agency," Kustin explained.

TIC forms are another area on which CCOs may wish to lean on outside capital. "They are not perfectly suited to private fund advisers," Kustin conceded. "They are intended more for operating companies, so clients often struggle to figure out what kind of information to include."

See "A Guide for Private Fund Managers to Evaluate Whether They Are Required to File TIC Form SHL – Due August 30, 2019" (Aug. 13, 2019).

Corporate Transparency Act

The Corporate Transparency Act of 2021 took effect on January 1, 2024, making this year the first in which filings identifying a business' beneficial owners and company applicants are required. Although broad exemptions cover many private fund managers, some will fall under its purview – and those managers might not even know it.

"If CCOs have not already heard of the Corporate Transparency Act, they are going to want to get on top of any reporting obligations they may have there," Kustin said. "To the extent they have entities in place within the scope that were formed before 2024, they are going to have a bunch of filings that are required before the end of this year."

See "Navigating the New FinCEN Beneficial Ownership Reporting Regime" (Jul. 11, 2024).

Form D Filings

Rule 506 under the Securities Act of 1933 bars private fund managers with certain connections to "bad actors" – *i.e.*, covered persons with criminal convictions or SEC cease-and-desist orders related to securities laws – from using Regulation D's exemption to raise money from accredited investors. As part of the "reasonable care" exception under the rule, managers must get bad-actor representations from investors and affiliates (*e.g.*, placement agents).

"Fund managers do not necessarily need to obtain those bad-actor representations at year-end, but year-end is a good time to make sure that it has happened," Kustin noted. Hummel suggested engaging outside counsel for any required filings, as they "usually take a bit more legal knowledge" than may be available on a compliance team.

Investor Reporting

EOY is also an excellent time for CCOs to verify that their funds have satisfied the various reporting obligations that inure to, or that result from, their fund investors. Some of those are statutory or legal obligations, such as the annual delivery to investors of any updates to a fund's privacy policy notices, Kustin elaborated.

Beyond that, fund managers are also subject to reporting obligations to some or all of their fund investors that flow from negotiated terms in their fund documents, which should be reviewed as part of the EOY compliance checklist process. For example, CCOs should ensure all LP advisory committee (LPAC) reporting requirements were satisfied in the previous year, as well as whether any new investments or other business matters require LPAC involvement going forward.

In addition, CCOs must be aware of their obligations under any side letters – especially those with EOY triggers. "There could be complicated reporting requirements that you've agreed to with investors," Kustin explained, which will require significant time and resources to complete. "Advisers are going to want to plan well in advance of year-end to make sure they can comply with those," he added.

Leadership Reporting

Many tasks the CCOs must undertake in the fourth and first quarters will require the participation of colleagues from all parts of a firm, including senior leadership. Mendez suggested reviewing any compliance testing done during the first three quarters and reporting the findings to senior executives and the board of trustees during the fourth quarter, laying out areas of potential improvement in the new year.