

Debevoise lawyer: GPs shouldn't rush to self-report

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Partner Julie Riewe, who was a former SEC asset management unit co-chief, thinks there isn't much upside for GPs to self-report compliance issues to the regulator.

The US Securities and Exchange Commission has ramped up its enforcement activities in private equity this year, with Apollo Global Management agreeing to a \$52.7 million settlement for allegedly misleading its limited partners on fees and expenses, and First Reserve paying a \$3.5 million settlement for alleged misallocation of fees and expenses.

The increased regulatory oversight has left many general partners wondering what to do if they find a compliance issue within their firms or funds. Debevoise partner and former co-chief of the SEC asset management unit Julie Riewe believes, except in the most extenuating circumstances, GPs shouldn't rush to self-report to the regulator.

Should GPs self-report to the SEC, or another regulator, if they find any problems?

The decision whether to self-report or not in any particular matter is a difficult one and really depends on the specific facts of the matter. As generally presented, the case against self-reporting is often compelling for clients. There are no objective guidelines for reporting compliance-related issues and if GPs do come forward, there is no measurable credit afforded. As a result, many, if not most times, it appears that there is no real upside to self-reporting, and, on the downside, self-reporting will be disruptive to the firm's business because doing so guarantees a regulatory investigation on the self-reported issue.

Self-reporting question aside, GPs take their compliance function seriously, both because they are fiduciaries and because LPs, many of which are fiduciaries themselves, demand robust compliance structures. When GPs discover an issue, they handle it internally and with their LPs as appropriate.

Have you seen cases of GPs self-reporting compliance issues?

We certainly see some GPs determine that self-reporting is the appropriate outcome in some situations, but no one is rushing to self-report everything immediately. Instead, GPs appropriately focus first on addressing the issues they identify with their LPs. GPs have the autonomy and are best positioned to appropriately tailor their compliance efforts and proactively resolve any issues themselves, without needing a regulator to step in.

Again, firms strive to be best-in-class in terms of compliance. They self-evaluate their compliance programs constantly, including by reviewing SEC orders and absorbing exam deficiency letters, and asking themselves whether their compliance program comports with SEC expectations given their particular business.

How would GPs know they've properly resolved the issue on their own without self-reporting?

GP clients always at least consider self-reporting when they discover an issue. I understand the impulse because they're trying to do the right thing for their LPs and their regulators. Rather than rushing to a conclusion that self-reporting is the answer, though, the issues GPs quickly need to address are: is the discovered conduct ongoing? If it is, make sure to end it. Did the conduct cause harm, for example monetary harm to the LPs, or did it cause existing disclosures to be misleading in some way? If so, determine how best to remedy it. Typically, GPs conduct an internal investigation and, in most cases, are able to resolve any issues internally and/or with their LPs. In this way, GPs rightly take responsibility for any issues, without needing to involve the regulators. Self-reporting is a separate step to consider in terms of managing any residual regulatory risks, but it necessarily follows the GPs making sure that they address whatever underlying conduct they have identified in a way that is consistent with their responsibilities to their LPs.

How do you think LPs perceive this self-responsibility?

LPs in general should prefer that their GPs to resolve issues internally without involving regulators. As long as a GP informs its LPs about discovered issues as necessary and appropriate, why would LPs want their GP to divert its attention from managing their assets to deal with a time-consuming and expensive regulatory investigation concerning an issue it had already resolved internally?

Would the pressure on self-reporting change as a result of the new US president?

I don't think so. The tension will persist: regulators will continue to encourage self-reporting and GPs will continue to choose to address issues internally and with their LPs and then evaluate self-reporting as appropriate. It's not clear what the new administration's SEC-related priorities will be, although they will largely be shaped by the new SEC chair and the new commissioners. As with any administration change, it's possible that priorities will shift – and especially concerning rulemaking objectives – but the reality is that much of the SEC's work will continue uninterrupted. I don't anticipate much if any change for the enforcement or examination programs; those programs did not change course when the Obama administration came into office and I similarly do not expect any significant changes with the Trump administration.